PETITION FOR WRIT OF CERTIORARI

105

Supreme Court, U.S.
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No. 08-370

In The

Supreme Court of the United States

NEIL C. GORDON, as Trustee,
Petitioner,

v.

NOVASTAR MORTGAGE, INC.,
Respondent.

NEIL C. GORDON, as Trustee,
Petitioner,

v.

ABN AMRO MORTGAGE GROUP, INC.,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Is the transfer of an interest "perfected" under 11 U.S.C. § 547(e)(1)(A) only when a secured party has done all the acts required to perfect its interest, or at the moment as of which state law may retroactively deem that perfection effective?

2. In avoiding late-perfected liens under 11 U.S.C. § 547, does the "substantially contemporaneous exchange" defense of § (c)(1) override the stated time limit of § (e)(2)?

RULE 14.1(b) STATEMENT

A list of all parties to the proceeding in the court whose judgment is the subject of this petition is as follows:

Plaintiff-Appellant and Petitioner: Neil C. Gordon, as trustee.

Defendants-Appellees and Respondents: NovaStar Mortgage, Inc; ABN Amro Mortgage Group, Inc.

Debtors: Tracey Joseph Hedrick; Theresa Ann Hedrick; Som R. Sharma; Santosh K. Sharma.

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PETITION FOR A WRIT OF CERTIORARI

Neil C. Gordon, as trustee in the bankruptcy cases of In re Hedrick and In re Sharma ("Gordon") respectfully petitions for a writ of certiorari to review the opinion and judgment of the U. S. Court of Appeals for the Eleventh Circuit.

OPINIONS BELOW

The Opinion of the U.S. Court of Appeals for the Eleventh Circuit, filed April 15, 2008, is officially reported at 524 F.3d 1175, and is reproduced at App. C, 7a-36a. The Panel's Opinion on Petition for Rehearing, filed June 4, 2008, is officially reported at 529 F.3d 1026, and is reproduced at App. B, 4a-6a. The Denial of the Petition for Rehearing en Banc, filed June 23, 2008, is reproduced at App. A, 1a-3a.

The Opinion and Judgment of the U.S. District Court for the Northern District of Georgia, Atlanta Division (the "District Court"), in Gordon v. NovaStar Mortgage, Inc. (In re Hedrick), filed February 23, 2007, is unofficially reported at 2007 U.S. Dist. LEXIS 69426, and is reproduced at App. D, 37a-38a and App. E, 39a-40a.

The decision of the United States Bankruptcy Court for the Northern District of Georgia, Atlanta Division (the "Bankruptcy Court") in Gordon v. NovaStar Mortgage, Inc. (In re Hedrick), filed August 31, 2005, is unofficially reported at 2005 Bankr. LEXIS 1923, and is reproduced at App. F, 41a-66a.

The Opinion and Judgment of the U.S. District Court for the Northern District of Georgia, Atlanta Division (the "District Court"), in Gordon v. ABN Amro Mortgage Group, Inc. (In re Sharma), filed February 23, 2007, is unofficially reported at 2007 U.S. Dist. LEXIS 69428, and is reproduced at App. G, 67a-68a and App. H, 69a-70a.

The decision of the United States Bankruptcy Court for the Northern District of Georgia, Atlanta Division (the "Bankruptcy Court") in Gordon v. ABN Amro Mortgage Group, Inc. (In re Sharma), filed October 31, 2005, is unofficially reported at 2005 Bankr. LEXIS 3036, and is reproduced at App. I, 71a-88a.

JURISDICTION

The opinion and judgment of the U.S. Court of Appeals for the Eleventh Circuit to be reviewed was entered on April 15, 2008, and amended by the panel's modification and denial of Gordon's petition for panel rehearing on June 4, 2008. The Circuit denied Gordon's petition for rehearing en banc on June 23, 2008. This petition is timely under 28 U.S.C. § 2101(c) and Supreme Court Rule 13.3 because it is filed within 90 days of entry of the denial of the motion for rehearing en banc of the opinion and judgment sought to be reviewed. This Court has jurisdiction to review the judgment of the Circuit Court under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant statutory provision involved is 11 U.S.C. § 547, as last amended before the effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). The section is reproduced in full at App. J, 89a-96a. These provisions are directly involved:

First Question

(e)(1) For the purposes of this section--

> (A) a transfer of real property . . . is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee.
>
> (B) a transfer of a fixture or property other than real property is perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee.

11 U.S.C. § 547(e)(1).

Second Question

(e) . . . (2) for the purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made--

> (A) at such time as the transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time, except as provided in subsection (c)(3)(B);
>
> (B) at the time such transfer is perfected, if such transfer is perfected after such 10 days . . . .

11 U.S.C. § 547(e)(2).

* * *

> (c) The trustee may not avoid under this section a transfer –
>
> (1) to the extent that such transfer was—
>
> (A) intended . . . to be a contemporaneous exchange for new value given to the debtor; and
>
> (B) in fact a substantially contemporaneous exchange[.].

11 U.S.C. § 547(c)(1).

STATEMENT OF THE CASE

The judgment below arises from judgments of bankruptcy courts in two separate proceedings: Gordon v. NovaStar Mortgage, Inc. (In re Hedrick); and Gordon v. ABN Amro Mortgage Group, Inc. (In re Sharma). In each case Gordon, as the trustee, sought

under 11 U.S.C. § 547 (preferential transfers) to avoid a lien[1] that was not filed of record within the ten day period then prescribed in 11 U.S.C. § 547(e)(2).[2] The bankruptcy court had jurisdiction to hear each proceeding under 28 U.S.C. § 157(b)(2)(F) ("proceedings to determine, avoid, or recover preferences").

Gordon v. NovaStar

At issue in Gordon v. NovaStar is the meaning of "when . . . cannot acquire" in this subsection:

> (A) a transfer of real property . . . is perfected *when* a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected *cannot acquire* an interest that is superior to the interest of the transferee.

11 U.S.C. § 547(e)(1)(A) (emphasis added).

In its opinion below (the "Circuit Opinion"), the Eleventh Circuit looked to Georgia laws of equitable subrogation and inquiry notice to determine how a transferee such as this defendant ("NovaStar") could

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[1] The common conveyance to a lender in Georgia is a deed to secure debt, not a mortgage. That difference is immaterial to this petition. We use "lien" to mean the lender's interest, and "deed" to mean the document memorializing that interest.

[2] Unless otherwise indicated, references to title 11, U.S.C. (the "Bankruptcy Code") are to its version just prior to the BAPCPA amendments. BAPCPA increased the grace period to 30 days.

perfect its interest in its collateral. The Eleventh Circuit concluded that, after the refinancing of a loan secured by real property, a subsequent purchaser can acquire an interest superior to the property's new lien if and only if that lien is filed of record after the cancellation of the old lien is filed.[3] App. C, 18a-20a.

The Circuit Opinion then concluded that if the new lender files first, its lien is "perfected" under § 547(e)(1)(A) as of the moment that the old lien was paid off. Conversely, if the old lender files its cancellation first, then the new lien is not "perfected" until it is filed. Since NovaStar filed first, NovaStar's lien was perfected retroactively to the moment of payoff:

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[3] We believe that the Eleventh Circuit misstated Georgia law. The court said that "a purchaser of an interest in property has inquiry notice, and thus *cannot* be a bona fide purchaser, if he acquires his interest before earlier creditors' security deeds are canceled." App. C, 18a (emphasis added). The opinion cited Rossville Federal Savings & Loan Association v. Chase Manhattan Bank, 223 Ga. 188, 154 S.E.2d 243 (Ga. 1967). However, in Rossville the subsequent purchaser had introduced no evidence to show that it had made any inquiry at all. "*There is no evidence* that the intervenor made any inquiry regarding the uncanceled security deed of record. *Under these circumstances*, the intervenor is not a bona fide purchaser." 154 S.E. 2d at 246 (italics added). Neither Georgia statute nor the Georgia courts have ever created the per se inquiry notice rule that the decision below articulates. Rather, a purchaser would have the opportunity to introduce evidence showing it had nonnegligently performed its duty to inquire and still failed to learn about the earlier, unfiled transfer. O.C.G.A. § 23-1-17. The words "cannot acquire" in 11 U.S.C. § 547(e)(1) demand an irrebutable presumption, but Georgia creates only a rebuttable presumption.

> In the present case no bona fide purchaser could acquire an interest superior to NovaStar's because the earlier security deeds were not cancelled until after the NovaStar security deed was recorded . . .. If NovaStar's security deed had not been properly recorded before the other security deeds were cancelled, it would not have been perfected until it was recorded or the world was put on notice by some other means. That, however, is not what happened.

App. C, 20a.

Accordingly, the last act, indeed the only act, that Georgia requires for NovaStar to perfect its lien is to file its deed.[4] The question is when that act takes effect under the federal statute. For the reasons set forth below, Gordon believes that NovaStar's lien was "perfected" under § 547(e)(1)(A) only when NovaStar actually filed its lien.

Pinning the date that a transfer was "perfected" matters for this reason. 11 U.S.C. § 547 operates to avoid liens that were "perfected," as defined in § (e)(1), after the end of a grace period created in § (e)(2), and within a certain period before the borrower becomes a debtor in a bankruptcy case under § (b)(4) (called the "reachback" period).[5] A lender may actually perform

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[4] Georgia also permits perfection through possession, O.C.G.A. § 44-5-169, but that did not occur here.

[5] The reachback period is one year for insiders and 90 days for all others, including the lenders in these cases. We explain this process at p. 16, n. 10 below.

the last act needed to get the transfer "perfected" after the federal grace period ends and during the reachback period, but state law may then recognize the perfection as of an earlier date that occurs either within the federal grace period, or before the reachback period, or both. The lien is avoided if the actual date is chosen, but the lien is preserved if the retroactive, "deemed" date is chosen.

Gordon v. NovaStar is such a case. NovaStar refinanced the debtors' home through a closing held on December 4, 2003. Two existing liens were paid off on December 12. The § 547(e)(2) grace period ended on or about December 19 (two day weekend, three business days for a right to rescind, and a ten day grace period). The 90 day reachback period began on January 6, 2004. NovaStar filed its deed to secure debt on January 7, 2004. The two prior lenders' deeds were marked "cancelled" on the land records on January 22, 2004. App. C, 11a, 21a. The lien filing date (January 7, 2004) is both beyond the grace period (Dec. 19, 2003) and within the reachback period (January 6, 2004). The payoff date (Dec. 12, 2003) is neither.

Gordon filed a complaint in bankruptcy court alleging that NovaStar's lien was "perfected" when filed and that all other preference avoidance requirements were met. On cross motions for summary judgment, the Bankruptcy Court recognized equitable subrogation. It denied Gordon's motion and granted NovaStar's. App. F, 41a-66a. The District Court affirmed essentially without opinion. App. D, 37a-38a.

Gordon argued throughout that equitable subrogation alone is not dispositive, because a

subsequent bona fide purchaser ("BFP") without notice acquires a superior interest in any event.[6] So regardless of whether NovaStar's lien was legal – arising from agreements signed at closing – or equitable – tacking to earlier lenders' liens – the dispositive question under § 547(e)(1)(A) is this: when was notice of NovaStar's lien sufficient so that a subsequent BFP could not acquire an interest superior to it? The Eleventh Circuit replied to that argument as set forth above, and held that NovaStar's lien was perfected no later than the December 12, 2003 payoff date. App. C, 20a-21a.

The Second Question and Gordon v. ABN Amro Mortgage Group, Inc.

The second question concerns Gordon v. ABN Amro Mortgage Group, Inc. (In re Sharma). There ABN Amro Mortgage Group, Inc. ("ABN") refinanced the debtor's home at a closing held on May 20, 2003. The old liens were paid off about May 28. The grace period ended on or about June 2 (including three days for rescission). ABN filed its lien on June 10, and the old liens were cancelled at some time after that. App. C, 21a-22a. The 90 day reachback period had begun before the closing.

Gordon filed a complaint in bankruptcy court alleging that ABN's lien was "perfected" when filed on June 10, 2003, and that all other preference avoidance

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[6] **"Interference with bona fide purchaser.** A bona fide purchaser for value without notice of an equity will not be interfered with by equity." O.C.G.A. § 23-1-20.

requirements were met. On cross motions for summary judgment, the Bankruptcy Court followed the earlier opinion in Gordon v. NovaStar to deny Gordon's motion and to grant ABN's. App. I, 71a-88a. The District Court affirmed. App. G, 67a-68a.

The Eleventh Circuit affirmed Gordon v. ABN on a different theory than in Gordon v. NovaStar, as follows. As noted above, § 547(e)(2) sets forth a rigid grace period as part of the prima facie avoidance case. Section 547(c) contains affirmative defenses. Section 547(c)(1), quoted above, creates a flexible, case-by-case grace period for the "substantially contemporaneous exchange." The Circuit ruled that § 547(c)(1) overrides § 547(e)(2), and then found that the subject transfer satisfied the affirmative defense. App. C, 34a-36a.

For the reasons set forth below, Gordon believes that § 547(c)(1) does not apply to § 547(e) cases at all.

REASONS FOR GRANTING THE PETITION

I. The First Question

1. Is the transfer of an interest "perfected" under 11 U.S.C. § 547(e)(1)(A) only when a secured party has done all the acts required to perfect its interest, or at the moment as of which state law may retroactively deem that perfection effective?

Gordon seeks review for these reasons. The Eleventh Circuit's answer to that question squarely conflicts with this Court's ruling in Fidelity Financial Services, Inc. v. Fink, 522 U.S. 211, 216 (1998) ("a transfer [under § (e)(1)(B)] is 'perfected' only when the

secured party has done all the acts required to perfect its interest, not at the moment as of which state law may retroactively deem that perfection effective"). The words "when . . . cannot acquire" cannot carry one meaning in § (e)(1)(B) and the opposite meaning in the companion provision that precedes it.

The Eleventh Circuit's answer also conflicts with Congress's expressions of intent contained within the predecessor bankruptcy statute and elsewhere, this Court's earlier decision in Corn Exchange National Bank & Trust Co. v. Klauder, 318 U.S. 434 (1943), and the recent rulings of two other courts of appeal.

By permitting retroactivity at all, the Circuit Opinion frustrates a policy that Congress has considered highly important for over a century: the prompt public noticing of liens. And as the Circuit Opinion interprets Georgia law, that noticing may occur with impunity even years later. The defendant transferee may delay its own act indefinitely, as long as an independent third party, the replaced lender, delays filing is lien cancellation at least one moment longer. But the decision below would still deem the subject transfer "perfected" under § 547(e)(1)(A) way back when the replaced lender received its payoff.

A. Gordon v. NovaStar flatly conflicts with Fidelity Financial Services, Inc. v. Fink, 522 U.S. 211 (1998).

In Fidelity Financial Services, Inc. v. Fink, 522 U.S. 211 (1998), this Court interpreted the same three words, "when . . . cannot acquire," in § 547(e)(1)(A)'s companion statute, § (e)(1)(B) (subjecting personalty

transfers to a judgment lien creditor test). There a Missouri law provided that a transfer properly noticed within 20 days related back for priority purposes to the transaction date. The federal grace period under § 547(e)(2) was 10 days. If the last act needed for perfection, namely the filing, occurred 15 days out, was the transfer "perfected" under § (e)(1)(B) at that moment in real time, or at the earlier moment when Missouri law deemed the perfection to be effective?

In Fink, the Court heard the same argument that the Eleventh Circuit adopted below: under applicable state law, a subsequent creditor "cannot acquire" a superior interest at any time during the federal grace period, because an event occurring after the federal grace period, namely, the defendant transferee's timely filing its lien under state law, has retroactive effect under state law. This Court rejected that argument as follows:

> Although Fidelity and two Courts of Appeals have thought this provision means that a transfer is perfected as of whatever date an enabling creditor could claim in a priority fight with a contract creditor armed with a judicial lien, the statute does not speak in such terms. Rather, it says that a transfer is perfected "When" a contract creditor "cannot acquire" a superior lien. "When" and "cannot acquire" are ostensibly straightforward references to time and action in the real world, not tip-offs (like the terms "as if" and "deemed") that the clock is being turned back in some legal universe.

522 U.S. at 216 (emphasis added). This Court concluded:

> Not until the secured party actually performs the final act that will perfect its interest can other creditors be foreclosed conclusively from obtaining a superior lien. It is only then that they "cannot" acquire such a lien. Thus, the terms of *§ 547(e)(1)(B)* apparently imply that a transfer is "perfected" only when the secured party has done all the acts required to perfect its interest, not at the moment as of which state law may retroactively deem that perfection effective.

Ibid.

Of course the same words, in this case "when . . . cannot acquire," would normally carry the same meanings in two adjacent provisions that have the same purpose. We cannot reconcile the Circuit Opinion's different meaning by arguing that Congress intended a harsher result for personalty lienors than for realty lienors. In fact the opposite is true; see p. 18 below.

Nor can we reconcile the Circuit Opinion by pointing out differences between Missouri law and Georgia law. In Missouri, the transferee races to file against a clock – the state's 20 day grace period. In Georgia, the transferee races to file against a third party – the replaced lender. But in both cases, the transferee who wins its race is *deemed* to have received its prize before it began to run.

In fact Georgia law, as the Circuit Opinion recites it, presents the greater conflict with the federal scheme. Congress wrote 11 U.S.C. § 547(e) to encourage prompt public noticing of liens. See p. 15 et seq. below. Missouri, at least, sets a date certain. The question is whether a state may unilaterally add 10 extra days of grace within a federal avoidance statute.

But Georgia sets no date. NovaStar could delay its lien filing indefinitely, as long as it ultimately files its deed before the old lenders file their cancellations. Following a December 4, 2003 closing, NovaStar could file its deed on January 7, 2008, rather than January 7, 2004, and thereby perfect its interest retroactively to December 12, 2003 -- as long as the replaced liens were cancelled of record after January 7, 2008, rather than after January 7, 2004. The question here is whether a state may unilaterally thwart the federal avoidance statute entirely.

In addition, retroactivity dependent in part on a third party creates more problems than retroactivity dependent on the defendant transferee alone. For example, how does a bankruptcy court apply the Eleventh Circuit's ruling, if neither the potential defendant transferee nor the replaced lender has filed anything before a debtor files a bankruptcy case? Must the trustee track down the replaced lender and get a lien cancellation filed of record, before suing the transferee? May the trustee file the old lender's lien cancellation?

B. Fink follows Corn Exchange National Bank & Trust Co. v. Klauder, 318 U.S. 434 (1943), and an unbroken line of Congressional Intent.

Fink represents too strong a line of thought on too important an issue to let the Circuit Opinion stand. The Bankruptcy Code's immediate ancestor is the Bankruptcy Act of 1898, former title 11, U.S.C. (the "Act"). Congress has tried to use bankruptcy law to encourage prompt public noticing of liens since 1903.[7] Its early attempts failed.[8] In 1938 Congress responded with a mechanism that, with some later refinements, is repeated in the present Code, as follows.[9]

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[7] Collins v. Greater Atlantic Mortgage Corporation (In re Lazarus), 478 F.3d 12, 16 et seq. (1st Cir. 2007) recites the legislative history.

[8] Speaking for the Court, Justice Jackson wrote this:

> [F]or thirty-five years Congress has consistently reached out to strike down secret transfers, and the courts have with equal consistency found its efforts faulty or insufficient to that end.

Corn Exchange, supra, 318 U.S. at 438.

[9] Chandler Act of June 22, 1938, 52 Stat. 840, 869-870; former 11 U.S.C. § 96a; Act § 60a. The provision's formulation immediately before the Bankruptcy Code formulation appeared at Act § 60a(2), 2d sentence:

> A transfer of real property shall be deemed to have been made or suffered when it became so far perfected that no subsequent bona fide purchaser from the debtor could create rights in such property superior to the rights of the transferee.

At the closing of a secured transaction, two things happen simultaneously: a lender transfers loan proceeds to or for the borrower's benefit, thus creating a debt; and the borrower transfers to the lender an interest in the borrower's property to secure repayment of that debt. Congress created a legal fiction that if the lender did not give prompt enough notice of the transaction, the statute would deem the transfer of that security interest to occur after the closing. The debt would become antecedent to its collateralization. That time lag would trigger the preference statute:

> By thus postponing the effective time of the transfer, the debt, which is effective when actually made, will be made antecedent to the delayed effective date of the transfer and therefore will be made a preferential transfer in law, although in fact made concurrently with the advance of money.

Corn Exchange National Bank & Trust Co. v. Klauder, 318 U.S. 434, 437 (1943).[10]

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[10] The legal fiction today employs two verbs: "made" and "perfected." Section 547(b)(2) provides that, as one requirement for a transfer to be avoided, the transfer must be for "antecedent debt owed . . . before such transfer was made." Section 547(e)(1) defines "perfected." Section (e)(2) ties the two verbs together by providing that the transfer is deemed "made" back when it became effective between the parties – i.e., when the debtor received the loan proceeds -- if it is "perfected" within a prescribed period afterwards. (We have called that the "grace period.") Otherwise the transfer is deemed "made" only when it is "perfected." Accordingly, the § 547(b)(2) requirement for antecedent debt is

The question remains, how do we define proper noticing? Here Congress recognized the generally applicable principle, traceable back to common law, that a bona fide purchaser of property, if without adequate legal notice of an earlier prior transfer from the same debtor, acquires a superior position in the property. Congress then looked to state law to determine what constituted adequate legal notice.

Originally the standard of perfection against a hypothetical BFP (the "BFP test") applied to all property transfers, real and personal; no bifurcation existed as in current §§ 547(e)(1)(A) and (e)(1)(B). Literally applied, the BFP test appeared to hamper normal and good transactions involving accounts receivable financing. The question arose as to whether the new BFP test would be applied literally or not. In Corn Exchange, supra, this Court said yes, as follows:

> [The Act's] apparent command is to test the effectiveness of a transfer, as against the trustee, by the standards which applicable state law would enforce against a good-faith purchaser. Only when such a purchaser is precluded from obtaining superior rights is the trustee so precluded. So long as the transaction is left open to possible intervening rights to such a purchaser, it is vulnerable to the intervening bankruptcy.

318 U.S. at 437-438.

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fulfilled only if the lender's lien was "perfected" after the grace period expires.

The Corn Exchange Court told lenders that if they had a problem, they should talk to Congress. They did. In 1950 Congress softened the test for personalty transactions by substituting a hypothetical judgment lien creditor for the hypothetical BFP – the forerunners to current §§ (e)(1)(A) and (e)(1)(B). 64 Stat. 24 (1950). When Congress cloned its test with but one mutation, Congress gave no indication that the words common to both provisions should convey different meanings in each one.

Finally, Congress showed what importance it places on prompt lien noticing by inserting an expression of legislative intent within the Bankruptcy Act itself. That expression speaks to this case:

> The recognition of equitable liens [e.g., NovaStar's equitable subrogation lien here] where available means of perfecting legal liens have not been employed [i.e, filing the deed] is hereby declared to be contrary to the policy of this section. If . . . (A) applicable law requires a signed and delivered writing, or a delivery of possession, or a filing or recording, or other like overt action as a condition to its full validity against third persons . . . and (B) such overt action has not been taken, and (C) such transfer results in the acquisition of only an equitable lien, *then such transfer is not perfected* . . . .

Act § 60a(6), former 11 U.S.C. § 96a(6) (emphasis added).

C. Gordon v. NovaStar conflicts with Results of Two Other Circuits.

The Circuit Opinion also conflicts with recent rulings in two other circuits. In all three cases a trustee sued under § 547(e) to avoid a refinancing lien, the new lender filed its lien beyond the grace period, and the replaced lien's cancellation was filed later still. The defendant's theory in the other two cases was earmarking, not equitable subrogation. However, both other cases show recognition of the statute's purpose and legislative history.

One case is Collins v. Greater Atlantic Mortgage Corporation (In re Lazarus), 478 F.3d 12 (1st Cir. 2007). There the First Circuit examined the statute's legislative history in depth. The court then held that the earmarking theory did not apply to excuse an otherwise untimely filing, and that the contemporaneous exception defense of § 547(c)(1) does not apply to § (e) cases. We discuss the second holding below.

The other case is Chase Manhattan Mortgage Corporation v. Shapiro (In re Lee), 530 F.3d 458 (6th Cir. 2008), which followed Collins to deny application of the earmarking theory. In that case the lender ("Chase") had refinanced its own earlier loan, and had neither canceled the old mortgage nor filed the new one. Chase argued among other things that "at all relevant times third parties were on notice of Chase's secured interest in the [p]roperty." The Sixth Circuit replied:

> But the fact that third parties may have been on notice of Chase's Original Mortgage is beside the point. A transfer of an interest in real estate is not necessarily perfected for purposes of *§ 547(e)* when third parties have notice that there *had been* a mortgage on the property. Rather, a transfer of real property "is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected *cannot acquire* an interest that is superior to the interest of the transferee." *11 U.S.C. § 547(e)(1)(A)* (italics original).

530 F.3d at 466. (emphasis added).

In short, the Circuit Opinion directly conflicts with Fink, contradicts a century of congressional attempts to encourage prompt lien filings, indirectly conflicts with Corn Exchange, and reaches a contrary result to two other circuit cases decided since 2007. Gordon therefore asks the Court to grant certiorari on the first question.

II. The Second Question

II. In avoiding late-perfected liens under 11 U.S.C. § 547, does the "substantially contemporaneous exchange" defense of § (c)(1) override the stated time limit of § (e)(2)?

The First Circuit in Collins, supra, and the Sixth Circuit in Ray v. Security Mutual Finance Corporation (In re Arnett), 731 F.3d 358 (6th Cir. 1984) answer that question no. The Eleventh Circuit joins the Eighth

Circuit in Linquist v. Dorholt, Inc. (In re Dorholt, Inc.), 224 F.3d 871 (8th Cir. 2000) and the Ninth Circuit Bankruptcy Appellate Panel in Dye v. Rivera (In re Moreno), 193 B.R. 907 (9th Cir. BAP 1996), aff'd w/o opinion, 117 F.3d 1425 (9th Cir. 1997),[11] to answer the question yes. In addition, the opinions that answer yes cite Pine Top Ins. Co. v. Bank of Am. Nat'l Trust & Sav. Ass'n, 969 F.2d 321, 328-29 (7th Cir. 1992) for support, but that case did not involve this question. See note 15 below at p. 32.

The answer to the question makes this difference. Section 547(e) sets forth a rigid, mechanical test: the court finds or calculates four dates: when the transaction became effective between the parties: when the grace period ended (10, now 30 days later); when the transfer became "perfected" under § (e)(1); and when the reachback period began (90 days or 1 year before the bankruptcy filing). If the perfection date is both after the grace period ends and within the reachback period, then the transfer is avoidable. If only one or neither factor is true, then the transfer is saved.

Two beneficial results follow. First, cases can be resolved efficiently on both sides, usually at the settlement or summary judgment stage, because the facts are simple and the conclusion is clear. Second,

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[11] The Ninth Circuit said only, "[w]e affirm substantially for the reasons stated by the Bankruptcy Appellate Panel in its opinion." 1997 U.S. App. LEXIS 16334. With exceptions not relevant here, "[u]npublished dispositions and orders of this Court are not precedent[.]" Ninth Cir. Rule 36-3(a).

Congress's emphatically expressed intent to encourage prompt lien filings is upheld.

Section (c)(1), on the other hand, is highly fact-intensive, and there is no clear rule of decision. As applied, "substantially contemporaneous" is what the trial court says it is, after considering an amalgam of whatever objective and subjective facts the court deems relevant, and subject to appeal on the "clearly erroneous" standard as one finding of fact. Litigation costs go up, and Congress's intent is thwarted.

Gordon seeks certiorari to resolve that split.

A. 11 U.S.C. § 547(c)(1) undermines § (e)(2) because § (e) has a wholly separate function from the rest of § 547.

Section (e)(2) sets forth a grace period that applies only to § (e) cases. Section (c), by contrast, sets forth an affirmative defense generally applicable to all cases brought under § 547. Accordingly, the question turns on whether or not to apply the canon of construction that the specific governs the general.[12] We believe that

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[12] The Court recognizes the "canon ('the specific governs the general') as a warning against applying a general provision when doing so would undermine limitations created by a more specific provision[,]" even when the Court is divided on its particular application. Varsity Corporation v. Howe, 516 U.S. 489, 511 (1995); compare, "[t]he law is settled that however inclusive may be the general language of a statute, it will not be held to apply to a matter specifically dealt with in another part of the same enactment." Id. at 519 (Justice Thomas in dissent; internal citation omitted).

Congress never intended § (c)(1) to apply to § (e) cases, and now argue that this canon should be invoked.

The first reason is that § (c)(1) undermines the limitation of § (e)(2). This phenomenon occurs because the essential function of § (e) differs 180 degrees from the general function of § 547, as follows. In general, the Bankruptcy Code is an equity code. And "[i]n general, [§ 547] is intended to discourage creditors from racing to dismember a debtor sliding into bankruptcy and to promote equality of distribution to creditors in bankruptcy." Linquist v. Dorholt, supra, 224 F.3d at 873 (internal citation omitted).

By contrast, § 547(e) and its counterparts, § 544(a) and § 545(2), are regulatory, punitive provisions. They act to prompt lenders into giving timely public notice of their liens. They do so by penalizing those who do not. And the penalty is perhaps draconian: those who give notice late, and are caught up in a borrower's bankruptcy, forfeit their property interests.

In direct contrast to acts and omissions that have consequences elsewhere in the Bankruptcy Code, this penalized act or omission may itself cause no direct harm to other creditors and no diminution to the estate. The lender may itself make no attempt to dismember a debtor. Chances are the missed deadline has itself caused no inequality of distribution – particularly if the deadline is missed by only a day or two. And before we apply the legal fiction inherent in § (e) alone, see p. 16 above, the parties' concededly honest intent is to create a perfectly simultaneous exchange of loan proceeds to the borrower, and a collateral property interest back to the lender.

It is not the nature of equity to attach consequences to an actor who neither intends to cause harm (a subjective test) nor in fact causes harm (an objective test). But that *is* the nature of regulation. If we can make an analogy of going too fast rather than too slow, motorists are ticketed for speeding every day. It is not a defense that they did not in fact hit anybody. It is not a defense that they really intended to cruise under the limit. It is not a defense that the particular line drawn between fair and foul (55/56 MPH) is arbitrary. And it is not a defense that another motorist who drove 20 miles an hour faster did not get ticketed. Rather, the point of regulation is that, by assessing penalties to those unlucky enough to get caught, we create a climate that lowers the possibility of real harm to everyone, including the speeding motorists themselves.

Section § 547(e) and its counterparts work the same way for those who do not timely notice their liens. They get caught only because, for what may be completely independent reasons, their borrowers declare bankruptcy soon afterwards. They intended no harm. The pre-2005 line between 10 and 11 days was arbitrary, and the post-2005 line between 30 and 31 days is no less arbitrary. Others whose borrowers didn't go bankrupt filed late and kept their liens. Yet despite all that, § 547(e) penalizes these lienors because, at least as Congress has determined, the absence of such regulation would raise the possibility of harm to all creditors:

> Despite the inherent equity of the transaction, the lien forfeiture "is necessary since, otherwise, parties would be free to conceal the fact of a lien and, thereby, the debtor's real financial

> condition, thus making the debtor appear financially sounder than he in fact is. The penalty is therefore quite properly imposed on the creditor who does not record.

In re Markham, 254 F. Supp. 948, 959 (W.D. Va. 1966) (citations omitted).

Applying the § (c)(1) affirmative defense to a § (e) case undermines § (e)'s function in two ways: it increases the costs of enforcement as noted above; and it results in fewer avoidances.

B. The undermining increases because courts that apply § (c)(1) in § (e)(2) cases misinterpret both provisions.

Invariably, courts that apply § (c)(1) at all misunderstand the distinct nature of § (e). They then misinterpret § (c)(1) itself, and occasionally § (e)(2) as well. This process undermines § (e) even further, as follows.

The trustee first proves a prima facie case through a provision, § (e), whose sole purpose, as noted above, is to avoid transfers despite the presence of such normally mitigating factors as contemporaneous new value in fact, "inherent equity," and the absence of harm to others. But courts then apply an affirmative defense, § (c)(1), to exempt the transfer for the very reason that those same factors are present:

> Consistent with [the general purpose above], *§ 547(c)(1)* provides that a transaction is *not* a preferential transfer, even if made on the eve of

> bankruptcy, if the creditor provides new value in exchange for the debtor's contemporaneous transfer of, for example, a security interest. Other creditors are not adversely affected by such an exchange because the debtor's estate has received new value.

Linquist v. Dorholt, supra, 224 F.3d at 873 (internal citation omitted) (emphasis original).

Courts applying § (c)(1) in § (e) cases invariably collect all equitable considerations they may find relevant, stir them into one pot, and reach a single conclusion of fact that passes the "clearly erroneous" test on appeal. The trial judge measures the time gap between closing and filing, apportions fault for it, and then gives or denies a reprieve based on some inverse, sliding scale between the length of the delay and the negligence of the defendant.

Here are examples. "That [the defendant transferee] was neither dilatory nor negligent in his actions is significant." Dye v. Rivera, supra, 193 B.R. at 916. The defendant transferee's "security interest would have been perfected more quickly but for a service bureau's filing error. Thus, her loan appears to be precisely the type of transaction that the *§ 547(c)(1)* exception was intended to protect." Linquist v. Dorholt, supra, 224 F.3d at 874. "The most important fact may be whether the delay in perfecting the interest was the result of negligence or intentional delay by the creditors." Circuit Opinion, App. C, 35a. The transferee was not "attempting to acquire a secret lien or otherwise [acting] with bad faith," Circuit Opinion, App. C, 36a.

The "substantially contemporaneous" defense existed at common law from 1917 until codified within the 1979 Bankruptcy Code; see the history in the section just below. However the defense may have been structured before codification, its plain meaning afterward does not support the interpretations quoted just above. Section (c)(1) says this:

> (c) The trustee may not avoid under this section a transfer –
>
> > (1) to the extent that such transfer was—
> >
> > > (A) intended . . . to be a contemporaneous exchange for new value given to the debtor; and
> > >
> > > (B) in fact a substantially contemporaneous exchange[.].

The statute itself differs from the treatment it is given in two respects. First, there is no single pot into which we dump all imaginable, and accordingly relevant, equitable considerations. There is no single sliding scale. Rather, § (c)(1) has two independent requirements, one subjective and the other objective. Second, the objective standard does not demand actual harm at all; rather, it only provides a flexible grace period.

We discuss the two requirements in turn. First, all the subjective factors concerning the defendant's intent to make a contemporaneous exchange for new value, its negligence, its clean hands, or whatever are clearly relevant to § (c)(1)(A). However, those

subjective factors are not needed; rather, the parties' intent to make a contemporaneous exchange for new value is already conceded in virtually every § (e) avoidance action. If two parties sit in a room together, pass a check in one direction, and pass a signed deed in the other, one can scarcely argue that they intended anything but a contemporaneous exchange for new value. This Court has already noted that the transfer was "in fact made concurrently with the advance of money." Corn Exchange, supra, 318 U.S. at 437. Only the Code-made legal fiction created through § (e)(1) and § (e)(2) creates a different result.

These same subjective factors are not relevant to § (c)(1)(B) at all, and objective considerations of actual harm are not dispositive. The subsection begins with the words "in fact." The noun "exchange" applies to the objective existence of a transfer in one direction (the loan proceeds) coupled with a transfer in the other direction (the collateral interest). "Contemporaneous" connotes an objective fact of being at the same time, i.e., one part of the exchange happens at the same time as the other. That is the fact to which the words "in fact" refer.

Finally, the adverb "substantially" neither incorporates subjectivity nor invites evidence of harm. "Substantially" means "essentially" or "mostly," and is itself neutral between the subjective and the objective. An egg is no more or less "substantially overcooked" if I simply forgot to return to the kitchen than if I ran to get my child out of a tree first. In this case, the adjective that "substantially" modifies,

"contemporaneous," does not gain subjectivity through its adverb.[13]

In short, equity includes such basic considerations as subjective intent and actual harm. As noted above, those considerations are not probative to § (e)(2). Subjective intent is not properly probative to § (c)(1)(B) either, and actual harm is far from necessary. To return to the earlier analogy, a car wreck may be used as evidence of speeding, but it is not necessary to the offense. However, courts that try to overlay § (c)(1) over § (e) in effect require the prosecutor to prove not only simple speeding, but vehicular homicide as well.

Courts that apply § (c)(1) to § (e) cases may misinterpret § (e) as well. For example, Linquist v. Dorholt, supra, 224 F.3d at 874, said that the purpose of § (e)(2) is not to define a grace period at all; rather, it is to stop the 90 day or one year reachback period under § (b)(4) from beginning until the transfer is perfected. However, if we wanted to accomplish that task, we could simply take out the word "made" at the beginning of § (b)(4) and substitute "perfected." We could then leave in § (e)(1) for its definition of "perfected," and omit § (e)(2) entirely.

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[13] The following interpretation conflicts with the plain meaning of "substantially:" "'[T]he modifier 'substantial' makes clear that contemporaneity is a flexible concept which requires a case-by-case inquiry into all relevant circumstances (e.g., length of delay, reason for delay, nature of the transaction, intentions of the parties, possible risk of fraud) surrounding the allegedly preferential transfer.'" Dye v. Rivera, supra, 193 B.R. at 914, quoting Pine Top Insurance Co., supra, 969 F.2d at 328.

The Circuit Opinion offered this second example:

> *Section 547(e)(2)(A)*'s purpose is to move some transfers that occur within the ninety-day preference avoidance period and would otherwise be avoidable outside of that period. The transfers it applies to are those that take place within eighty to ninety days before the petition is filed, provided that they are perfected within ten days.

App. C, 31a (emphasis added). By that interpretation, the only grace period left for all transfers perfected within 80 days of the bankruptcy filing is the affirmative defense of § (c)(1) itself. The Eleventh Circuit abandoned this ruling on rehearing. App. B, 4a-6a.[14]

It is not coincidence that courts seeking to fit § 547(c)(1) into § (e) cases misinterpret one or both provisions. Both § (c)(1) and § (e)(2) are grace periods, pure and simple. One determines the length of grace through a case-by-case method, and the other applies a one-size-fits-all method. The pressure to misinterpret arises from the perceived need to give meaning to each

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[14] The abandoned holding explains why the court below addressed this question at all. By its calculation, the subject transfer was perfected within the § (e)(2) grace period. "Under equitable subrogation [the court's ruling in Gordon v. Novastar], ABN's interest was perfected when [the two taken-out lenders] received their checks from ABN to pay off the Sharmas' debts, which the parties agree probably occurred on May 28, 2003. This was eight days after the closing." Circuit Opinion at App. C, 36a. A finding that an eight day gap satisfies a § (c)(1) grace period is necessary only if the ten day grace period of § (e)(2) does not apply.

provision of a statute, and accordingly to apply them both at once.

However, the canon to give meaning to every provision does not dictate that we give all meaning all the time. The very nature of the "the specific governs the general" canon is that the provision with general applicability keeps its full meaning except for the place that it does not apply at all. That is the case here. Section (c)(1) continues to apply to all § 547 actions that do not implicate § (e). Those concern late payments to creditors, and comprise the vast majority of all preference avoidances. An exception for § (e) does not swallow the rule of § (c)(1).

C. Congress intended the rigid grace period now in § (e)(2) to replace the "substantially contemporaneous" grace period now in § (c)(1).

The history of §§ (c)(1) and (e)(2) indicates that they were never intended to operate together, as follows.

As noted above, Congress first tried to regulate late lien filings through bankruptcy law in 1903. In the beginning, the statute itself contained no grace period at all. The first and only grace period was the "substantially contemporaneous" standard. This Court provided it in 1917. Dean v. Davis, 242 U.S. 438 (1917), involved a transaction attacked as both preferential and fraudulent. The case involved the grant of a mortgage on the debtor's property. The mortgage was apparently filed eight days after closing (September 3 and 11, 1909). The Court held that the transfer was not preferential because, at p. 443, the

loan constituted a "substantially contemporaneous advance."

That grace period for late lien filing preference cases existed on a common law, case-by-case basis for the next thirty three years. According to Collins, supra, 478 F.3d at 17 (footnote omitted), "in 1950, a 21-day grace period for perfection was added. *Act of Mar. 18, 1950, ch. 70, § 1, 64 Stat. 24, 26.* The legislative history reveals that this last was designed to create 'an appropriately rigid time limitation.' H.R. Rep. No. 81-1293 (1949)." A rigid, one-size-fits-all statutory grace period replaced the flexible, case-by-case common law grace period.[15] Then 1979 the Bankruptcy Code not only recodified the rigid standard within § 547(e)(2) (tightening the period to 10 days), but also, for the first time, codified the common law "substantially contemporaneous" grace period into § (c)(1).

So on the face of it, we have moved from one grace period at common law (1917-1950), to another grace period through statute (1950-1979), to competing grace periods within the statute (1979-present). And that presents us with competing canons of construction

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[15] Pine Top did not address the question of § (c)(1)'s applicability to a § (e) case. It "look[ed] to federal bankruptcy law for guidance" in interpreting a "preference dispute under state insurance law." Because the insurance statute was enacted in 1937, "the Bankruptcy Act of 1898, rather than the Bankruptcy Code of 1978, is considered most germane to its interpretation." 969 F.2d at 324. Like the Bankruptcy Act before 1950, the insurance statute itself did not contain any grace period at all, rigid or flexible. Pine Top decided how it would apply the "substantially contemporaneous" grace period to its case.

noted above: do we try to give meaning to all parts of a statute all the time; or does the specific govern the general? We suggest that Congress intended the latter in this case for three reasons.

First, as noted above, § (c)(1) retains plenty of meaning if we limit its applicability to all actions that do not implicate § 547(e), namely, the vast majority of § 547 actions that concern late payments to creditors. The direct legislative history of § (c)(1) supports this view. "The contemporaneousness test was added late in the day to address a much broader generic problem--ordinary exchange of goods for check or credit payment--where recording and other perfection devices do not exist." Collins, supra, 478 F.3d at 19.

Second, the notion of resurrecting a requirement that is less rigid, more dependent on subjective factors, and more variable case-by-case, runs counter to other preference law revisions that appeared at the same time. Bankruptcy Code § 547(f) contained a new presumption of insolvency to remove the need to prove insolvency case-by-case, absent the defendant's introduction of evidence to the contrary. And the new § 547 dropped a subjective requirement found in the old Act's preference section: that the defendant have "reasonable cause to believe that the debtor is insolvent" was deleted (Act § 60b, former 11 U.S.C. § 96b).

Finally, as noted above, the new Bankruptcy Code split its provisions that avoid the late-perfected liens into three separate places. The first is § 544(a) (rights of a lien creditor or BFP as of the commencement of the case). The next is § 545(2) (avoidance of statutory

liens). The last is § 547(e). The common law "contemporaneous exchange" defense cropped up only in § 547. There is no reason why that defense should apply to one group of late-lien-filing cases and not to others.

* * *

In conclusion, the circuits are split on this second question. Like the first, this question affects bankruptcy practice all over the country. Gordon therefore asks the Court to grant certiorari on the second question.

Dated: September 18, 2008
Atlanta, Georgia

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APPENDIX

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

Nos. 07-11179, 07-11187

[Filed June 23, 2008]

No. 07-11179-HH

In Re: TRACY JOSEPH HEDRICK, THERESA ANN HEDRICK,	)
Debtors.	)
NEIL C. GORDON, Trustee for the Estate of Tracy Joseph Hedrick and Theresa Ann Hedrick,	)
Plaintiff-Appellant,	)
versus	)
NOVASTAR MORTGAGE, INC.,	)
Defendant-Appellee.	)

No. 07-11187-HH

In Re: SOM R. SHARMA,	)
	)
Debtor.	)
	)
NEIL C. GORDON, Trustee for the Estate of Santosh K. Sharma,	)
	)
Plaintiff-Appellant,	)
	)
versus	)
	)
ABN AMRO MORTGAGE GROUP, INC.,	)
	)
Defendant-Appellee.	)
	)

On Appeal from the United States District Court for the Northern District of Georgia

Before: CARNES and BARKETT, Circuit Judges, and COHN,* District Judge.

PER CURIAM:

The Petition(s) for Rehearing are DENIED and no Judge in regular active service on the Court having requested that the Court be polled on rehearing en

* Honorable James I. Cohn, United States District Judge for the Southern District of Florida, sitting by designation.

banc (Rule 35, Federal Rules of Appellate Procedure), the Petition(s) for Rehearing En Banc are DENIED.

ENTERED FOR THE COURT:

/s/ Ed Carnes
UNITED STATES CIRCUIT JUDGE

APPENDIX B

IN THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

Nos. 07-11179, 07-11187

[Filed June 4, 2008]

No. 07-11179
D.C. Docket No. 05-02689-CV-TCB
BKCY No. 04-06420-BKC-JE

In Re: TRACY JOSEPH HEDRICK, THERESA ANN HEDRICK,	)
Debtors.	)
NEIL C. GORDON, Trustee for the Estate of Tracy Joseph Hedrick and Theresa Ann Hedrick,	)
Plaintiff-Appellant,	)
versus	)
NOVASTAR MORTGAGE, INC.,	)
Defendant-Appellee.	)

No. 07-11187
D.C. Docket No. 05-03123-CV-TCB-1
BKCY No. 03-68468-BKC-MGD

In Re: SOM R. SHARMA,	)
	)
Debtor.	)
	)
	)
NEIL C. GORDON, Trustee for the Estate of Santosh K. Sharma,	)
	)
Plaintiff-Appellant,	)
	)
versus	)
	)
ABN AMRO MORTGAGE GROUP, INC.,	)
	)
Defendant-Appellee.	)
	)

Appeals from the United States District Court
for the Northern District of Georgia

ON PETITION FOR REHEARING

Before CARNES and BARKETT, Circuit Judges, and COHN,* District Judge.

PER CURIAM:

---

* Honorable James I. Cohn, United States District Judge for the Southern District of Florida, sitting by designation.

After considering the appellant's petition for panel rehearing and suggestion for rehearing en banc, we revise our opinion filed on April 15, 2008, and published at 524 F.3d 1175, in one respect. The first two sentences of the first full paragraph on page 1189 are deleted, and the following sentence is substituted in their place:

> Section 547(e)(2)(A)'s primary purpose is to defeat § 547(b)(2)'s antecedent debt requirement by causing transfers that are perfected within ten days to be "made" at the time of the transfer. *See Dorholt v. Linquist (In re Dorholt, Inc.)*, 239 B.R. 521, 523 (B.A.P. 8th Cir. 1999), *aff'd*, 224 F.3d 871 (8th Cir. 2000); 5 Collier on Bankruptcy ¶ 547.05[5][a], at 547-97 (15th ed. rev. 2006).

With regard to the other issues raised, the petition for panel rehearing is DENIED. This order does not affect appellant's petition insofar as it is a suggestion for rehearing en banc.

A True Copy - Attested
Clerk U.S. Court of Appeals,
Eleventh Circuit

By: /s/
Deputy Clerk
Atlanta, Georgia

APPENDIX C

UNITED STATES COURT OF APPEALS
ELEVENTH CIRCUIT

Nos. 07-11179, 07-11187

[Filed April 15, 2008]

In Re: Tracy Joseph HEDRICK, Theresa Ann Hedrick,	)
Debtors.	)
Neil C. Gordon, Trustee for the Estate of Tracy Joseph Hedrick and Theresa Ann Hedrick,	)
Plaintiff-Appellant,	)
v.	)
Novastar Mortgage, Inc.,	)
Defendant-Appellee.	)
In Re: Som R. Sharma,	)
Debtor.	)
Neil C. Gordon, Trustee for the	)

Estate of Santosh K. Sharma,)
)
Plaintiff-Appellant,)
)
v.)
)
ABN Amro Mortgage Group, Inc.,)
)
Defendant-Appellee.)
)

Appeals from the United States District Court for the Northern District of Georgia.

Before CARNES and BARKETT, Circuit Judges, and COHN,* District Judge.

CARNES, Circuit Judge:

In this consolidated appeal, Neil Gordon, the Chapter 7 Trustee of the bankruptcy estates of Tracy and Theresa Hedrick and Santosh and Som Sharma, appeals the bankruptcy courts' grants of summary judgment to NovaStar Mortgage, Inc. and ABN Amro Mortgage Group, Inc., respectively. The trustee brought the adversary proceedings that gave rise to this appeal to avoid the transfer of security deeds[1] in

* Honorable James I. Cohn, United States District Judge for the Southern District of Florida, sitting by designation.

[1] The record and parties' briefs at various points refer to the interests acquired by the defendants and to the earlier interests that the defendants paid off as both "mortgages" and "security deeds." Under Georgia law, the two are not the same, *see Cole v.*

the debtors' properties under 11 U.S.C. § 547(b) (2000) (*amended by* the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub.L. No. 109-9, 119 Stat. 23 (2005)).[2] That subsection of the Bankruptcy Code permits trustees to avoid certain preferential transfers of interests in a debtor's property that occur within ninety days before the filing of a bankruptcy petition. The effect of doing so is to convert a creditor's claim secured by property of the debtor to an unsecured one against the estate.

The bankruptcy courts granted summary judgment to the defendant companies after concluding that under Georgia's law of equitable subrogation the transfers of the security deeds were "made" for § 547(b)(4) purposes on the date the loans closed instead of on the later date when the security deeds were recorded. That meant in the Hedricks' case that the transfer to NovaStar occurred before the § 547(b) preference avoidance period began and, as a result, the

---

Cates, 110 Ga.App. 820, 140 S.E.2d 36, 39 (1964) ("[A] deed conveys title; a mortgage is only a lien." (quoting *Loftis v. Alexander*, 139 Ga. 346, 77 S.E. 169, 170 (1911))), but the difference between them is not relevant to this case. For convenience we will refer to the interests transferred to the defendants as "security deeds" or "deeds to secure debt" (which are synonymous), which is what the bankruptcy court orders call them.

[2] When Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, it modified some of the provisions of the Bankruptcy Code relevant to this case, but all of the events in question here occurred before BAPCPA. Unless otherwise noted, all citations to the Bankruptcy Code refer to it as it was before those amendments.

trustee could not avoid the transfer of the security deed. It meant in the Sharmas' case that the transfer qualified for the § 547(c)(1) contemporaneous exchange exception and, as a result, the trustee could not avoid the security deed.

The trustee's appeals of the bankruptcy court judgment in each case were heard by the same district court judge in a joint hearing. The court issued identical orders stating that it found the bankruptcy courts' orders to be well-reasoned, and it affirmed their judgments. This is the trustee's appeal of the bankruptcy courts' grants of summary judgment to the defendant in each of the cases, which we have consolidated.

The undisputed, material facts of both cases are similar. The debtors refinanced debts secured by property interests in their homes, paying off the earlier creditors with loans from the new creditors. The new loans were secured by first priority security deeds on the homes. The cancellations of the earlier deeds to secure debt were not recorded until after the new security deeds had been recorded, and that recording of the new security deeds took place within the ninety-day period preceding the filing of the Chapter 7 petitions. The trustee for the bankruptcy estates initiated adversary proceedings to avoid the new security deeds under § 547(b), which provides for avoiding some preferential transfers that occur in the ninety-day period preceding the filing of a bankruptcy petition.

The significant difference between the two sets of debtors is that the creditors who originally held the

security deeds on the Hedricks' home were paid off more than ninety days before the Hedricks filed their joint bankruptcy petition, while the creditors who originally held the security deeds on the Sharmas' home were paid off fewer than ninety days before the Sharmas filed their joint bankruptcy petition. The details and our analysis follow, beginning with the Hedricks' case.

I.

Astoria Federal Savings and Countrywide Home Loans, Inc. each held a security deed on the Hedricks' home. On December 4, 2003, the Hedricks refinanced the debts secured by those deeds, paying off Astoria and Countrywide with $148,000 borrowed from NovaStar. The Hedricks' loan from NovaStar was secured by a first priority security deed on their home.

The federally mandated three business day rescission period on the refinancing loan expired on December 9, 2003. On December 10 NovaStar delivered checks to Astoria and Countrywide, paying off the Hedricks' debts to them in full. That same day NovaStar sent its new security deed to the county clerk to be recorded, but the document was not actually recorded until January 7, 2004. The cancellations of the old security deeds to Astoria and Countrywide were recorded on January 22, 2004.

On April 5, 2004, the Hedricks filed a joint petition for Chapter 7 bankruptcy. Thereafter the trustee asked the bankruptcy court to avoid NovaStar's security deed on the Hedricks' property under § 547(b)(4)(A). In order to rule on that request the

court had to determine when the transfer of the security deed was "made."

Section 547(e)(2)(A), the relation-back provision, states that a transfer is "made" at the time of the exchange if the interest received is perfected within ten days. The bankruptcy court applied Georgia's doctrine of equitable subrogation to find that the transfer of the security deed from the Hedricks to NovaStar was made when NovaStar paid off Astoria and Countrywide, which was on December 10, 2003. That date was within ten days of the exchange at the refinance loan closing. As a result, under § 547(e)(2)(A) the transfer was "made" at the time of the exchange, which was more than ninety days before the Hedricks filed their joint bankruptcy petition. Because the date of the exchange was more than ninety days before the bankruptcy petition was filed, the bankruptcy court held that the trustee was not entitled to avoid the transfer under § 547(b)(4)(A).

The court also held that, in any event, the trustee had failed to introduce sufficient evidence to survive summary judgment on one of the other elements of the avoidance provision: the requirement that the party seeking to avoid the transfer prove that the transferee received more from the transfer than it would have from Chapter 7 proceedings. *See* 11 U.S.C. § 547(b)(5)(A). On both of those grounds the bankruptcy court granted summary judgment to NovaStar. The district court did, too, and for the same reasons.

Whether the grant of summary judgment to NovaStar was correct depends on whether the transfer

of interest in the Hedricks' property was "made" outside the ninety-day preference avoidance period under § 547(b)(4)(A), which in turn depends on when NovaStar's security deed was perfected. *See* 11 U.S.C. § 547(b)(4)(A) (conditioning the trustee's ability to avoid the transfer on it having been "made ... on or within 90 days before the date of the filing of the petition").

When a transfer is "made" for § 547(b)(4)(A) purposes depends on when it is perfected. If the transfer is perfected within ten days of the exchange, it is considered to have been made when it occurred. 11 U.S.C. § 547(e)(2)(A). If the transfer is perfected more than ten days after the exchange, it is considered to have been made at the time it is perfected, which will be after the transfer occurred. *Id.* § 547(e)(2)(B). A transfer "is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee." *Id.* § 547(e)(1)(A).

The Bankruptcy Code does not define the term "bona fide purchaser." *Straight v. First Interstate Bank of Commerce* (*In re Straight*), 207 B.R. 217, 228 (10th Cir. BAP 1997). However, that term in the federal statute takes its common, ordinary meaning. *See id.* (applying the definition of "bona fide purchaser" in *Black's Law Dictionary* to the term in § 545 of the Bankruptcy Code); *see also United States v. Watkins*, 320 F.3d 1279, 1284 (11th Cir. 2003) (using the term "bona fide purchasers[,] as that term is commonly defined," in applying a federal civil forfeiture statute); *United States v. Hunter* (*In re Walter*), 45 F.3d 1023,

1030 (6th Cir. 1995) ("Where a statutory lien is created by federal law ... the characteristics of a bona fide purchaser will ... be determined by federal law."); *see generally Griffith v. United States* (*In re Griffith*), 206 F.3d 1389, 1392 (11th Cir. 2000) (en banc) ("In interpreting the language of a statute, we generally give the words used their ordinary meaning." (quoting *Moskal v. United States*, 498 U.S. 103, 108, 111 S.Ct. 461, 465, 112 L.Ed.2d 449 (1990)) (internal quotation marks omitted)). The common, ordinary meaning of a "bona fide purchaser" is "[o]ne who buys something for value without notice of another's claim to the property and without actual or constructive notice of any defects in or infirmities, claims, or equities against the seller's title; one who has in good faith paid valuable consideration for property without notice of prior adverse claims." *Black's Law Dictionary* 1271 (8th ed. 1999).

Whether an event is enough to put a purchaser on notice so that a bona fide purchaser "cannot acquire an interest that is superior to the interest of the transferee" is determined, the statute tells us by "applicable law," 11 U.S.C. § 547(e)(1)(A), which is to say the law of the state where the property is located. *See Gen. Motors Acceptance Corp. v. Busenlehner* (*In re Busenlehner*), 918 F.2d 928, 930 (11th Cir. 1991) (holding that state law determines when perfection occurs for purposes of the preference avoidance provision of the Bankruptcy Code), *overruled on other grounds by Fid. Fin. Servs., Inc. v. Fink*, 522 U.S. 211, 118 S.Ct. 651, 139 L.Ed.2d 571 (1998); *see also Corn Exch. Trust Co. v. Klauder* (*In re Corn Exch. Nat'l Trust Co.*), 318 U.S. 434, 436-37, 63 S.Ct. 679, 681, 87 L.Ed. 884 (1943) (holding that state law determines

when an interest is perfected when interpreting the preference avoidance provision of the Bankruptcy Act). The Hedricks' home is in Georgia, so the law of that state determines when NovaStar's interest was perfected.

NovaStar's interest was perfected under Georgia law at the time a bona fide purchaser could no longer have obtained an interest from the Hedricks in their home that was superior to NovaStar's. Under Georgia's recording statute, Ga.Code Ann. § 44-2-3, the world was on notice of NovaStar's security deed once it was recorded. Because of that, no one who purchased an interest after the recording of that security deed could have been a bona fide purchaser of an interest superior to NovaStar's. The dispute is whether a bona fide purchaser could have acquired an interest superior to NovaStar's during the period between the time NovaStar paid off the earlier creditors, thereby extinguishing their security deeds, and the time NovaStar's own security deed was recorded.

That determination turns on Georgia's doctrine of equitable subrogation and how it fits into the Bankruptcy Code. Equitable subrogation may benefit a party who "advances money to pay off an [earlier] encumbrance on realty either at the instance of the owner of the property or the holder of the encumbrance ... [and] the new security is for any reason not a first lien on the property." *See Bankers Trust Co. v. Hardy,* 281 Ga. 561, 640 S.E.2d 18, 20 (2007) (quoting *Davis v. Johnson,* 241 Ga. 436, 246 S.E.2d 297, 300-01 (1978)). In those circumstances if the new creditor is "not chargeable with culpable or inexcusable neglect, [it] will be subrogated to the rights of the prior

encumbrancer under the security held by [it], unless the superior or equal equity of others would be prejudiced thereby." *Id.* (emphasis omitted). NovaStar contends that no one could have obtained a superior interest to its security deed because it acquired a first priority interest in the Hedricks' home through equitable subrogation once it paid the earlier creditors. The trustee contends that equitable subrogation does not benefit NovaStar for two reasons.

First, he argues that as a general matter equitable subrogation cannot perfect an interest under the Bankruptcy Code. It cannot, the trustee argues, because equitable subrogation operates through the creation of an equitable lien and equitable liens are not recognized under the Bankruptcy Code. But equitable subrogation does not create an equitable lien; instead, it is an equitable doctrine which affects the priority of property interests that exist apart from equity. *Id.* at 19-20. In any event, even if equitable subrogation is seen as creating an equitable lien, the Code still incorporates "applicable law" into the § 547(b) preference avoidance provision, meaning that Georgia law controls. *See In re Busenlehner,* 918 F.2d at 930; *see also In re Corn Exch. Nat'l Trust Co.,* 318 U.S. at 436-37, 63 S.Ct. at 681. And the doctrine of equitable subrogation is alive and well in Georgia. *See Bankers Trust Co.,* 640 S.E.2d at 20. Therefore, if the requirements of equitable subrogation are met in this case, NovaStar's security deed enjoys the same priority as the earlier security deeds that NovaStar paid off.

The trustee's second argument is that, even if equitable subrogation can operate to perfect the transfer of a property interest for Bankruptcy Code

purposes, it did not do so here. His position is that the words "cannot acquire" in the § 547(e)(1)(A) definition of perfection of a transfer–"when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected *cannot acquire* an interest that is superior to the interest of the transferee"–requires us to determine if, under some hypothetical set of circumstances, someone might have been able to prevent equitable subrogation and get an interest superior to NovaStar's. If that could have happened, the trustee argues, then the interest was not perfected until it was recorded.

Even if the trustee is right about that, it does not carry the day for him because no intervening buyer could, under any set of hypothetical facts, have been a bona fide purchaser in this case. And only a bona fide purchaser would have the "superior or equal equity" necessary to prevent the operation of equitable subrogation. A bona fide purchaser is, as we have said, "one who has in good faith paid valuable consideration for property without notice of prior adverse claims." *Black's Law Dictionary* at 1271. What constitutes notice to the hypothetical purchaser is determined by state law. *See In re Busenlehner*, 918 F.2d at 930. Any purchaser who acquired an interest in the Hedricks' property during the period between the time NovaStar paid off the earlier debts and the time it recorded its own security deed could not be a bona fide purchaser under Georgia law, because the security deeds from the earlier debt remained on the record books and appeared to be in effect at all times during that period.

Georgia recognizes inquiry notice, which imputes knowledge of an earlier interest to a later purchaser of

an interest in land whenever there is "[a]ny circumstance which would place a man of ordinary prudence fully upon his guard, and induce serious inquiry." *See Page v. Will McKnight Constr., Inc.*, 282 Ga.App. 571, 639 S.E.2d 381, 383 (2006) (internal quotation marks and citation omitted). Under *Rossville Federal Savings & Loan Ass'n v. Chase Manhattan Bank*, 223 Ga. 188, 154 S.E.2d 243 (1967), a purchaser of an interest in property has inquiry notice, and thus cannot be a bona fide purchaser, if he acquires his interest before earlier creditors' security deeds are cancelled. *Id.* at 246.

In that case, Rossville Federal Savings held a security deed on a residential property. *Id.* at 245. In exchange for receiving a new security deed, First Trust Company sent a check to Rossville Federal to pay off the debt owed it. *Id.* After receiving that check, Rossville Federal sent its cancelled security deed to be recorded. *Id.* Before the check from First Trust cleared, First Trust, through an intermediary, sold the security deed to Chase Manhattan Bank. *Id.* Only after that happened was Rossville Federal's cancellation recorded. *Id.* The check from First Trust was returned for insufficient funds, and First Trust turned out to be insolvent. *Id.* The Georgia Supreme Court held that Rossville Federal could set aside its cancellation of its security deed in the property, reasoning that Chase Manhattan had inquiry notice, and so was not a bona fide purchaser, because the

First Trust deed was still recorded at the time Chase Manhattan took its interest. *Id.* at 246.[3]

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[3] The trustee has a hypothetical about how a purchaser could have acquired an interest superior to NovaStar's in the present case. He posits the possibility that during the period between NovaStar's payment of the earlier debts and the recording of NovaStar's security deed, a purchaser of an interest in the Hedricks' property, although on record notice of the earlier security deeds held by Astoria and Countrywide, might have contacted those two earlier creditors. They, the trustee continues to posit, might have told the purchaser not to worry about their security deeds because the underlying debt had been paid. The penultimate posit would be that the purchaser did not bother to ask, and neither Astoria nor Countrywide volunteered, that the payoff of the debt owed to them had been by another creditor, NovaStar, which now had a new security deed on the property. And the final posit would be that the Hedricks committed fraud by giving the purchaser what purported to be a first priority security deed in return for valuable consideration from him.

The trustee's house of cards hypothetical collapses under the weight of the *Rossville* precedent. Exactly the same set of imaginary circumstances could be conjured up for the period between the time that First Trust paid off the debt owed to Rossville Federal and the time that First Trust's new security deed was recorded in that case. In spite of the theoretical possibility that a purchaser could have been harmed by the delay in recording the new interest, the Georgia Supreme Court still held that because Rossville Federal's deed provided inquiry notice until its cancellation was recorded, there was no room for a bona fide purchaser. *Rossville Fed. Sav. & Loan Ass'n,* 154 S.E.2d at 246. That is the "applicable law." Applying it here, no bona fide purchaser could have acquired an interest superior to NovaStar's during the period between the time that NovaStar paid off the earlier debts and the time that it recorded its new security deed, because the earlier security deeds remained uncancelled insofar as the public recordings were concerned.

In the present case no bona fide purchaser could acquire an interest superior to NovaStar's because the earlier security deeds were not cancelled until after the NovaStar security deed was recorded. Before NovaStar recorded its security deed, a hypothetical intervening purchaser would have inquiry notice of it under *Rossville*. After NovaStar recorded its security deed, a hypothetical intervening purchaser would have constructive notice of that deed under the recording statute. *See* Ga.Code Ann. § 44-2-3. Thus, anyone who might have acquired an interest in the Hedricks' property would have had notice of one kind or another and could not have been a bona fide purchaser. The NovaStar security deed was therefore perfected under Georgia's doctrine of equitable subrogation as soon as Astoria and Countrywide received the checks paying off the Hedricks' debts to them. *See Bankers Trust Co.*, 640 S.E.2d at 20 (for equitable subrogation to apply a party must "advance[ ] money to pay off an encumbrance"); *Baker v. Hous. Auth. of Waynesboro*, 268 Ga.App. 122, 601 S.E.2d 350, 351 (2004) (defining "paid" to mean "... discharge of a debt or liability, by the *delivery* of money or other value by a debtor to a creditor" (emphasis added, citation omitted)). If NovaStar's security deed had not been properly recorded before the other security deeds were cancelled, it would not have been perfected until it was recorded or the world was put on notice by some other means. That, however, is not what happened.

NovaStar's checks to Astoria and Countrywide were sent on December 10, 2003 and cleared NovaStar's escrow account on December 12, 2003. Therefore, the latest that NovaStar perfected its interest under the doctrine of equitable subrogation was December 12,

2003. NovaStar's loan to the Hedricks closed on December 4, 2003. Because the delivery and the closing occurred within ten days of each other, the transfer was "made" at the closing for purposes of § 547(e)(2)(A)'s relation-back provision. The avoidance period, which was the ninety days preceding the Hedricks filing their joint Chapter 7 petition, did not begin until January 6, 2004. Therefore, the December 4, 2003 transfer at the closing was "made" outside the ninety day avoidance period, and the trustee may not avoid the security deed.

Because this is the case, we need not address the bankruptcy court's other ground for affirming the bankruptcy court's grant of summary judgment to NovaStar. We do, however, need to turn to the other case in this consolidated appeal.

II.

Santosh Sharma and Sanjiv Gupta, a non-debtor, jointly owned a home. Each had taken loans and given liens on his share of the property. On May 20, 2003, the two of them refinanced their debts by obtaining a $225,000 loan from ABN. ABN secured the loan with a first priority security deed on the home. The bulk of the new loan, $194,110.06, was to be paid to Union Planters Bank to fully satisfy the outstanding balance on Sharma's debt. The remainder, $27,860.85, was to be paid to Atlantic States Bank to fully satisfy Gupta's debt.

The federally mandated rescission period on the refinancing ended on May 23, 2003. On the next business day, which, due to the Memorial Day holiday,

was May 27, 2003, ABN sent disbursements by Federal Express to Union Planters and Atlantic. The parties agree that the checks could not have arrived before the following day, May 28, 2003. Also on May 28, ABN sent its security deed to the county clerk to be recorded, but it was not actually recorded until June 10, 2003.

On June 18, 2003, Santosh Sharma and her husband, Som Sharma, filed their joint petition for Chapter 7 bankruptcy. The county clerk recorded the cancellation of the Union Planters and Atlantic deeds to secure debt on the Sharma home on June 23 and 26, 2003, respectively.

In the bankruptcy court proceedings, ABN and the trustee both agreed that the transfer of the security deed to ABN was made within the ninety days preceding the filing of the Sharmas' bankruptcy petition. Ninety days before the petition was filed was March 20, 2003, two months before ABN's loan to the Sharmas closed. Although a trustee generally can avoid a transfer occurring within the ninety days before a debtor files a Chapter 7 bankruptcy petition if the transfer meets the other requirements of the preference avoidance provision, 11 U.S.C. § 547(b), there are exceptions. One of them is the contemporaneous exchange exception, *id.* § 547(c)(1), which exempts from avoidance transfers that are intended to be contemporaneous and are in fact at least substantially contemporaneous. The bankruptcy court granted summary judgment for ABN because, applying the doctrine of equitable subrogation, it found that the contemporaneous exchange exception applied. The district court agreed.

We have already discussed in some detail the doctrine of equitable subrogation in connection with the preference avoidance issue in the Hedricks' case. In the present case, ABN's security deed in the Sharma home acquired the priority of the earlier interests under the doctrine of equitable subrogation on May 28, 2003, when the checks from ABN arrived at Union Planters and Atlantic to pay off the Sharmas' debts to those two creditors. At that time, the exchange between ABN and the Sharmas was complete–ABN had given Union Planters and Atlantic the money necessary to satisfy the Sharmas' debts, and ABN had received a security deed in the Sharmas' home, which was immediately perfected through equitable subrogation.

Because May 28, 2003 is fewer than ninety days before the Sharmas filed for bankruptcy on June 18, 2003, the question is whether ABN qualifies for an exception to the § 547(b) preference avoidance provision. ABN contends that the eight days between the time the loan closed and the time it received a perfected interest in the Sharma home is close enough to be "substantially contemporaneous" for purposes of the § 547(c)(1) exception. If so, then the transfer of the security deed to ABN cannot be avoided by the trustee.

The exception applies when the transfer was: "(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and (B) [was] in fact a substantially contemporaneous exchange." 11 U.S.C. § 547(c)(1). The trustee does not dispute that the security deeds were intended to be contemporaneous exchanges for

new value given to the debtor, so the subparagraph (A) condition is met. The trustee does, however, contend that the exchange was not in fact substantially contemporaneous, as required by the subparagraph (B) condition.

We have not yet had the opportunity to define the term "substantially contemporaneous" in § 547(c)(1)(B) outside the context of enabling loans.[4] Other circuits have, and they have split over whether to transport

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[4] Enabling loans (i.e. purchase money security interests) have a specific exception to avoidance, which is found in § 547(c)(3). If the enabling loan is perfected in the statutorily defined period a trustee cannot avoid it. 11 U.S.C. § 547(c)(3). In *Gower v. Ford Motor Credit Co. (In re Davis)*, 734 F.2d 604 (11th Cir. 1984), a decision limited to enabling loans, we held that for an exchange that involves the transfer of an enabling loan to be "substantially contemporaneous" it must occur within the period of time allotted for perfection in § 547(c)(3), the enabling loan exception to avoidance. *Id.* at 605-07. We reasoned that Congress' intent in creating a specific provision governing enabling loans and a particular period for perfecting those loans would be circumvented by allowing creditors to perfect their interests outside that period and then use the contemporaneous exchange exception to prevent avoidance of their interests. *Id.* at 607.

The present case, however, does not involve an enabling loan, nor is there a specific provision in the Code that requires perfection of non-purchase money security deeds within a particular time, so *In re Davis*' holding does not control and its reasoning is not helpful here. *See Pongetti v. GMAC (In re Locklin)*, 101 F.3d 435, 443 n. 9 (5th Cir. 1996) ("We must distinguish carefully here between cases involving purchase money security interests and nonpurchase money security interests. In the former, circuit courts have uniformly ruled that lenders who failed to perfect within 10 days may not take advantage of the § 547(c)(1) exception. In the latter, circuit courts have split.").

the ten-day period specified in the relation-back provision, *id.* § 547(e)(2)(A), into "substantially contemporaneous," or instead define the term in a way that requires a case-by-case consideration of all the facts in order to decide if a given transfer was substantially contemporaneous. *Compare Collins v. Greater Atl. Mortg. Corp.* (*In re Lazarus*), 478 F.3d 12, 19 (1st Cir. 2007) (interpreting "substantially contemporaneous" as requiring the exchange to occur within the ten day relation-back period under § 547(e)(2)(A)), *and Ray v. Sec. Mut. Fin. Corp.* (*In re Arnett*), 731 F.2d 358, 363 (6th Cir. 1984) (same), *with Lindquist v. Dorholt, Inc.* (*In re Dorholt Inc.*), 224 F.3d 871, 874 (8th Cir. 2000) (holding that whether an exchange is "substantially contemporaneous" must be determined on a case-by-case basis), *and Dye v. Rivera* (*In re Marino*), 193 B.R. 907, 915 (9th Cir. BAP 1996) (same), *aff'd*, 117 F.3d 1425 (9th Cir. 1997); *see also Pine Top Ins. Co. v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 969 F.2d 321, 328 (7th Cir. 1992) (interpreting "substantially contemporaneous" in 11 U.S.C. § 547(c)(1)(B) to require a flexible inquiry in a state insurance law case).

We are unconvinced by the reasons that the First and Sixth Circuits have given for writing into § 547(c)(1)(B)'s "substantially contemporaneous" term the ten-day rule contained in § 547(e)(2)(A). *See In re Lazarus*, 478 F.3d at 19; *In re Arnett*, 731 F.2d at 363. The result in those circuits is a bright line rule that is drawn at the expense of adherence to the statutory language. Section 547(c)(1)(B) does not set out a bright line rule. It does not refer in any way to the ten-day period contained in § 547(e)(2)(A) or to any other provision's time standard. Congress chose, for

whatever reason, not to make ten days the time measure for § 547(c)(1)(B); it chose instead to make "substantially contemporaneous" the standard.

We have no license to assume that Congress did not mean what it said in § 547(c)(1)(B), but we are instead bound to assume that it meant exactly what it said. *See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6, 120 S.Ct. 1942, 1947, 147 L.Ed.2d 1 (2000) ("[W]e begin with the understanding that Congress says in a statute what it means and means in a statute what it says there .... [W]hen the statute's language is plain, the sole function of the courts–at least where the disposition required by the text is not absurd–is to enforce it according to its terms." (citations and internal quotation marks omitted)); *United States v. LaBonte*, 520 U.S. 751, 757, 117 S.Ct. 1673, 1677, 137 L.Ed.2d 1001 (1997) ("We do not start from the premise that this language is imprecise. Instead, we assume that in drafting this legislation, Congress said what it meant."); *see also United States v. Fisher*, 289 F.3d 1329, 1338 (11th Cir. 2002) ("The plain language is presumed to express congressional intent and will control a court's interpretation."). What Congress said in § 547(c)(1)(B) is not "within ten days" but "substantially contemporaneous." The plain meaning of that term conveys flexibility-the opposite of a hard and fast, bright line rule–and requires a case-by-case approach focused on the facts and circumstances. *See Pine Top*, 969 F.2d at 328.

The existence of a precise, bright line time measure in § 547(e)(2)(A) and in other parts of the Code, *see, e.g.*, 11 U.S.C. § 547(c)(3)(B) (twenty-day rule in the

enabling loans exception), does not weigh in favor of courts substituting one for the "substantially contemporaneous" measure specified in § 547(c)(1)(B). Instead, it weighs heavily against doing so because it shows that Congress knew how to write specific deadlines and precise time measures into the Code and did so when it believed use of one to be the best policy choice. The presence of specified time measures elsewhere in the Act makes the absence of one in § 547(c)(1)(B) all the more telling. *See Duncan v. Walker,* 533 U.S. 167, 173, 121 S.Ct. 2120, 2125, 150 L.Ed.2d 251 (2001) ("It is well settled that where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." (internal quotation marks omitted)); *Delgado v. United States Att'y Gen.,* 487 F.3d 855, 862 (11th Cir. 2007) ("[W]here Congress knows how to say something but chooses not to, its silence is controlling." (internal quotation marks and citation omitted)); *DIRECTV, Inc. v. Brown,* 371 F.3d 814, 818 (11th Cir. 2004) ("As we have previously stated, when Congress uses different language in similar sections, it intends different meanings." (internal quotation marks omitted)).

We might believe, as the First and Sixth Circuits apparently do, that Congress chose poorly in deciding not to use a more precise, easier to apply, bright line standard in § 547(c)(1)(B). It may be that revising the provision by importing a different standard from another part of the statute would improve things–it would certainly make it easier for courts to apply the provision. *In re Lazarus,* 478 F.3d at 19; *In re Arnett,*

731 F.2d at 364. We are not, however, authorized to revise statutory provisions in the guise of interpreting them. *See Artuz v. Bennett,* 531 U.S. 4, 10, 121 S.Ct. 361, 365, 148 L.Ed.2d 213 (2000) ("Whatever merits these and other policy arguments may have, it is not the province of this Court to rewrite the statute to accommodate them."); *Badaracco v. Comm'r,* 464 U.S. 386, 398, 104 S.Ct. 756, 764, 78 L.Ed.2d 549 (1984) ("Courts are not authorized to rewrite a statute because they might deem its effects susceptible of improvement."); *Albritton v. Cagle's, Inc.,* 508 F.3d 1012, 1017 (11th Cir. 2007) ("We are not empowered to rewrite statutes."); *United States v. Griffith,* 455 F.3d 1339, 1343 (11th Cir. 2006) ("The legislative branch does not require the help of the judicial branch for ... simple drafting task[s]."); *Harris v. Garner,* 216 F.3d 970, 976 (11th Cir. 2000) (en banc) ("We will not do to the statutory language what Congress did not do with it, because the role of the judicial branch is to apply statutory language, not rewrite it.").

We disagree with the premise of the First and Sixth Circuits that a court is authorized to interpret a statute contrary to the plain meaning of its words if doing so would, in the court's view, better further the purpose it thinks Congress had in mind. *See In re Lazarus,* 478 F.3d at 17-18 (stating that not interpreting "substantially contemporaneous" to mean within ten days would "specifically undercut Congress' purpose"); *In re Arnett,* 731 F.2d at 363. As the Supreme Court recently reminded us, "law depends on respect for language." *Watson v. United States,* --- U.S. ----, 128 S.Ct. 579, 585, 169 L.Ed.2d 472 (2007). We interpret and apply statutes, not congressional purposes. *Oncale v. Sundowner Offshore Servs., Inc.,*

523 U.S. 75, 79, 118 S.Ct. 998, 1002, 140 L.Ed.2d 201 (1998) ("[I]t is ultimately the provisions of our laws rather than the principal concerns of our legislators by which we are governed."); *United States v. Maung*, 267 F.3d 1113, 1121 (11th Cir. 2001) ("[W]e are governed by the language Congress enacts, not by purported designs or intentions that conflict with that language."); *CBS, Inc. v. PrimeTime 24 Joint Venture*, 245 F.3d 1217, 1227 (11th Cir. 2001). In any event, "[t]he best evidence of that [legislative] purpose is the statutory text adopted by both Houses of Congress and submitted to the President." *W. Va. Univ. Hosps., Inc. v. Casey*, 499 U.S. 83, 98, 111 S.Ct. 1138, 1147, 113 L.Ed.2d 68 (1991), *superceded by statute*, Civil Rights Act of 1991, Pub.L. No. 102-166, § 113, 105 Stat. 1071, 1079 (1991); *see Aldridge v. Williams*, 44 U.S. (3 How.) 9, 24, 11 L.Ed. 469 (1845) ("The law as it is passed is the will of the majority of both houses, and the only mode in which that will is spoken is in the act itself ....").

Nor do we agree with the First and Sixth Circuits that copying the ten-day rule from § 547(e)(2)(A) and pasting it over the "substantially contemporaneous" rule in § 547(c)(1)(B) is necessary to avoid negating § 547(e)(2). *In re Lazarus*, 478 F.3d at 18; *In re Arnett*, 731 F.2d at 363. The Sixth Circuit thought it necessary because otherwise "section 547(c)[(1)] effectively negates section 547(e)(2)," and "[s]uch hopeless conflict cannot have been intended by Congress." *In re Arnett*, 731 F.2d at 363. We disagree with the central premise. Reading the two provisions to mean exactly what they say does not negate either one of them, and there is no "hopeless conflict," intended or otherwise.

Section 547 of the Bankruptcy Code deals with preferences. The general rule, set out in subsection (b) of that section, is that a transfer of interests made within the ninety days before a debtor files a petition for Chapter 7 bankruptcy can be avoided by the bankruptcy trustee if it meets the other requirements in that subsection. There are exceptions to that general rule. One of those exceptions, which is set out in paragraph (c)(1) of § 547, provides that a transfer within ninety days may not be avoided by the trustee if two conditions are met. One condition is that the transfer was intended by both the debtor and the creditor to be a contemporaneous exchange for new value given, 11 U.S.C. § 547(c)(1)(A); the other condition is that the transfer was in fact a substantially contemporaneous exchange, *id.* § 547(c)(1)(B). That exception depends solely on those two conditions having been met. It does not require that the transfer have been perfected in ten days or any specified number of days.

Section 547(e)(2), by contrast, is not an exception to the general rule about avoiding transfers made within ninety days of the filing of a bankruptcy petition. It has a different purpose and field of operation than an exception. It is, instead, a provision that has to do with calculating the time of transfers for purposes of the preference provisions contained in other parts of § 547. Section 547(e)(2)(A) and (B) divide transfers into two categories: those that were perfected within ten days, which are to be considered as made when the transfer occurred; and those that were not perfected within ten days, which are to be considered as made when they were perfected.

Section 547(e)(2)(A)'s purpose is to move some transfers that occur within the ninety-day preference avoidance period and would otherwise be avoidable outside of that period. The transfers it applies to are those that take place within eighty to ninety days before the petition is filed, provided that they are perfected within ten days. There is no "substantially contemporaneous" requirement or inquiry under § 547(e)(2)(A); all that counts is whether the time between the date the transfer occurred and the date it was perfected was ten days or less. If so, the provision operates to move the date the transfer was made to the date of the exchange instead of the date of perfection. If not, the creditor is stuck with the date of perfection.

By contrast, § 547(c)(1) does not fix or move the date the transfer of an interest was made. It does not contain a ten-day rule. Instead, it asks only whether the transfer was meant to be a contemporaneous exchange for new value and, if so, whether it was "in fact a substantially contemporaneous exchange." If both of these conditions are met, the trustee may not avoid the transfer even if it was perfected more than ten days after the exchange and even if it occurred within ninety days, or nine days, or one day, of the filing of the bankruptcy petition.

Both § 547(c)(1) and § 547(e)(2)(A) have separate fields of operation, unless "substantially contemporaneous" is interpreted to mean "within ten days." If that interpretation is forced on the term "substantially contemporaneous," then § 547(e)(2)(A) will not have a field of operation. Every transfer for new value that would fit within the ten-day rule of that provision will automatically fit within the

"substantially contemporaneous" standard of § 547(c)(1)(B) and be saved by § 547(c)(1), because the two time periods for preventing perfection to avoid avoidance will be the same. The irony of the First and Sixth Circuits' interpretation is that it brings about the very result it seeks to avoid. It renders one provision superfluous, which is an interpretative no-no. *See Conn. Nat'l Bank v. Germain,* 503 U.S. 249, 253, 112 S.Ct. 1146, 1149, 117 L.Ed.2d 391 (1992) ("[C]ourts should disfavor interpretations of statutes that render language superfluous ...."); *United States v. Menasche,* 348 U.S. 528, 538-39, 75 S.Ct. 513, 520, 99 L.Ed. 615 (1955) ("The cardinal principle of statutory construction is to save and not to destroy. It is our duty to give effect, if possible, to every clause and word of a statute ...." (internal quotation marks and citations omitted)); *Platt v. Union Pacific R.R. Co.,* 99 U.S. 48, 58, 25 L.Ed. 424 (1879) ("[A] legislature is presumed to have used no superfluous words.").

Nor can the rewriting of the plain meaning of the words "substantially contemporaneous" in § 547(c)(1)(B) be justified on the basis of intent revealed in the legislative history of the provision. The primary reason is that courts must not resort to legislative history to cloud the meaning of statutory text that is plain. *Ratzlaf v. United States,* 510 U.S. 135, 147-48, 114 S.Ct. 655, 662, 126 L.Ed.2d 615 (1994); *see Darby v. Cisneros,* 509 U.S. 137, 147, 113 S.Ct. 2539, 2545, 125 L.Ed.2d 113 (1993) ("Recourse to the legislative history of [the statute at issue] is unnecessary in light of the plain meaning of the statutory text."); *Ins. Co. v. Ritchie,* 72 U.S. 541, (5 Wall.) 541, 545 (1867) ("[W]hen terms are unambiguous we may not speculate on probabilities of

intention."); *Harris*, 216 F.3d at 976 ("When the import of the words Congress has used is clear ... we need not resort to legislative history, and we certainly should not do so to undermine the plain meaning of the statutory language.").

In addition, even if we could resort to legislative history in construing the meaning of "substantially contemporaneous" in § 547(c)(1)(B), it would only reinforce the plain meaning of that term. The House Committee Report contained this commentary on the provision at issue:

> The first exception [(§ 547(c)(1))] is for a transfer that was intended by all parties to be a contemporaneous exchange for new value, and was in fact substantially contemporaneous. Normally, a check is a credit transaction. However, for the purposes of this paragraph, a transfer involving a check is considered to be "intended to be contemporaneous," and if the check is presented for payment in the normal course of affairs, which the Uniform Commercial Code specifies as 30 days, U.C.C. § 3-503(2)(a), that will amount to a transfer that is "in fact substantially contemporaneous."

H.R.Rep. No. 95-595, at 373 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 6329. Using payment of a check "in the normal course of affairs" as an example of a "substantially contemporaneous" exchange is antithetical to the notion of a bright line rule specifying a precise number of days. Besides, if one were going to substitute a set number of days for the "substantially contemporaneous" measure, this

legislative history shows that Congress would have favored the thirty-day period specified in U.C.C. § 3-503(2)(a), instead of the ten-day period specified in § 547(e)(2) at that time. The lesson we draw is that legislative revision is best left to the legislative branch.

For all of these reasons, we agree with the Eighth and Ninth Circuits that "substantially contemporaneous" does not mean the same thing as "within ten days." *In re Dorholt, Inc.*, 224 F.3d at 874; *In re Marino*, 193 B.R. at 915. We join them in holding that, unlike the ten-day bright line rule of § 547(e)(2)(A), the "substantially contemporaneous" rule of § 547(c)(1)(B) requires an examination of all the facts and circumstances. *In re Dorholt, Inc.*, 224 F.3d at 874; *In re Marino*, 193 B.R. at 915. It is a flexible standard that requires courts to make individualized findings.

In doing so, courts should take into account the objective reasonableness of the time taken to perfect the interest, the cause of any delay, and the motivations for it. The length of the delay between the transfer and perfection is one factor, although it is not necessarily dispositive. *See In re Marino*, 193 B.R. at 916. In considering the length of the delay, the nature of the transaction and how long a creditor in that type of transaction usually takes to perfect its interest in the normal course of affairs are relevant. *See Pine Top*, 969 F.2d at 328 (including "nature of the transaction" in "relevant circumstances" to determine whether an exchange is "substantially contemporaneous"); H.R.Rep. No. 95-595, at 373, *as reprinted in* 1978 U.S.C.C.A.N. at 6329 ("[In] a transfer involving a check [,] ... if the check is

presented for payment in the normal course of affairs ... that will amount to a transfer that is 'in fact substantially contemporaneous.'").

When considering whether the delay in perfection of the interest is reasonable given the creditor's specific circumstances, courts should again consider all the relevant facts. *See In re Arnett,* 731 F.2d at 360 ("The construction given to section 547(c)(1) by the lower courts in this case requires examination of all circumstances surrounding the transaction giving rise to the transfer. Thus, where delayed perfection of a security interest may be satisfactorily explained, and in the absence of dilatoriness or negligence on the part of a transferee, the transfer may still be found 'substantially contemporaneous' with the exchange of new value to the debtor, regardless of the lapse of time."). The most important fact may be whether the delay in perfecting the interest was intended by the creditor or resulted from its negligence. *See In re Marino,* 193 B.R. at 916 (noting that the creditor being "neither dilatory nor negligent in his actions is significant"). In particular, if the reason for delay is that the creditor is attempting to obtain secret liens, then this factor will weigh so heavily against the creditor that it ordinarily will be dispositive. *See Pine Top,* 969 F.2d at 328 (including "intentions of the parties" and "possible risk of fraud" in "relevant circumstances" to determine whether an exchange is "substantially contemporaneous").

Because we review *de novo* legal conclusions of the bankruptcy and district courts, *Hemar Ins. Corp. of Am. v. Cox* (*In re Cox*), 338 F.3d 1238, 1241 (11th Cir. 2003), and the historical facts are not in dispute, we

need not remand the Sharmas' case. We can decide ourselves whether the transfer of the security deed from the Sharmas to ABN falls within the § 547(c)(1) exception. *See Spaziano v. Singletary,* 36 F.3d 1028, 1041-42 (11th Cir. 1994) ("No remand will be necessary, because the ... issue is purely one of law and we would review the district court's decision of it *de novo* anyway."); *Macklin v. Singletary,* 24 F.3d 1307, 1312 (11th Cir. 1994) ("[W]ith issues subject to *de novo* review on appeal, our scope of review is at its broadest and our willingness to decide without the benefit of a district court ruling should increase commensurately.").

Under equitable subrogation, ABN's interest was perfected when Union Planters and Atlantic received their checks from ABN to pay off the Sharmas' debts, which the parties agree probably occurred on May 28, 2003. This was eight days after the closing. ABN sent its deed to be recorded on that same date, the first business day after the federally mandated rescission period had ended. The trustee does not even suggest that ABN was attempting to acquire a secret lien or otherwise acted with bad faith. Nor does he contend that waiting until after a federal holiday to send a deed to be recorded was outside the normal course of affairs for this kind of transaction. Considering all of the circumstances, we conclude that this was a substantially contemporaneous exchange under § 547(c)(1), so the trustee may not avoid it.

AFFIRMED.

APPENDIX D

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF GEORGIA ATLANTA DIVISION

CIVIL ACTION FILE NUMBER 05-CV-2689-TCB

[Filed February 23, 2007]

NEIL C. GORDON, Trustee for the Estate of Tracy Joseph Hedrick and Theresa Ann Hedrick,	)
Plaintiff/Appellant,	)
v.	)
NOVASTAR MORTGAGE, INC.,	)
Defendant/Appellee.	)

ORDER

Before the Court is Plaintiffs appeal of the Bankruptcy Court's August 31, 2005 order denying Plaintiffs motion for summary judgment and granting Defendant's motion for summary judgment.

In its appellate capacity, a district court may "affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings." Fed. R. Bank. P. 8013. The Court is bound by the bankruptcy court's findings of fact unless they are clearly erroneous, but the bankruptcy court's conclusions of law are subject to *de novo* review. *In re Calvert,* 907 F.2d 1069, 1071 (11th Cir. 1990).

The Court has carefully reviewed the entire record and has carefully examined the Bankruptcy Court's order. The Court finds that the order is thorough, well-reasoned, and correct in every respect. Accordingly, the judgment of the Bankruptcy Court is AFFIRMED.

The CLERK is DIRECTED to terminate all pending submissions and dismiss this appeal.

IT IS SO ORDERED this 23rd day of February, 2007.

/s/
Timothy C. Batten, Sr.
United States District Judge

APPENDIX E

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

BANKRUPTCY CASE NO. 04-06420-JEM
CIVIL ACTION FILE
NUMBER 1:05-CV-2689-TCB

[Filed February 23, 2007]

TRACY JOSEPH HEDRICK,	)
	)
Debtor,	)
	)
NEIL C. GORDON,	)
	)
Appellant,	)
	)
vs.	)
	)
NOVASTAR MORTGAGE, INC.,	)
	)
Appellee.	)
	)

JUDGMENT

This action having come before the court, Honorable Timothy C. Batten, Sr., United States District Judge, for consideration of the appeal of the

bankruptcy order entered 8/31/05, and the court having rendered its decision, it is

Ordered and Adjudged that the order of the bankruptcy court is **affirmed** and the appeal is **dismissed.**

Dated at Atlanta, Georgia this 23rd day of February, 2007.

JAMES N. HATTEN
CLERK OF COURT

By: s/Melissa Shalongo
Deputy Clerk

Prepared, Filed, and Entered
in the Clerk's Office
February 23, 2007
James N. Hatten
Clerk of Court

By: s/Melissa Shalongo
Deputy Clerk

APPENDIX F

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

CASE NO. 04-92733-JEM
CHAPTER 7, JUDGE MASSEY
ADVERSARY NO. 04-6420

[Filed August 31, 2005]

IN RE:	)
	)
Tracy Joseph Hedrick and	)
Theresa Ann Hedrick,	)
	)
Debtors.	)
	)
Neil C. Gordon as Chapter 7 Trustee,	)
	)
Plaintiff,	)
	)
v.	)
	)
NovaStar Mortgage, Inc.,	)
	)
Defendant.	)
	)

ORDER GRANTING DEFENDANT'S MOTION FOR SUMMARY JUDGMENT AND DENYING PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

In early December 2003, Tracy Joseph Hedrick and Theresa Ann Hedrick obtained a loan from NovaStar Mortgage, Inc. to refinance debt secured by two security deeds on their residence in Cobb County, Georgia. At the closing, they executed a new security deed on the residence in favor of NovaStar. A few days after the closing, the closing attorney sent checks to the holders of the prior security deeds, which they promptly cashed. NovaStar's security deed was not recorded until January 7, 2004. The security deeds of the prior lenders were marked cancelled on January 22, 2004. On April 5, 2004, eighty-nine days after NovaStar's security deed was recorded, the Hedricks filed a petition initiating this case under Chapter 7 of the Bankruptcy Code.

Neil Gordon, the Chapter 7 Trustee, contends that the recording of NovaStar's security deed constituted a transfer of an interest in Debtors' property within the 90-day period preceding the bankruptcy, while Debtors were insolvent, that enabled NovaStar to receive more than it would receive in the Chapter 7 case. He brings this adversary proceeding against NovaStar to avoid the transfer as a preference pursuant to section 547 of the Bankruptcy Code, 11 U.S.C. § 547.

NovaStar raises three defenses to Mr. Gordon's claim. First, it contends that under the doctrine of equitable subrogation, it held a perfected lien against

Debtors' residence as of the time it paid the prior lenders. Second, NovaStar argues that the making of the loan and recording of NovaStar's security deed were substantially contemporaneous and therefore that it has a defense under section 547(c)(1). Finally, it contends that the loan proceeds were "earmarked" to pay the prior lenders and never became property of the Hedricks and that because a preference by definition involves a transfer of a debtor's property, there was no preference.

Both parties move for summary judgment. Pursuant to Fed. R. Civ. P. 56(c), made applicable by Fed. R. Bankr. P. 7056, a party moving for summary judgment is entitled to prevail if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). The Court held a hearing on the motions on April 11, 2005, at which the parties agreed that there is no dispute on any material fact needed to decide this dispute.

In the latter part of 2003, Tracy Joseph Hedrick and Theresa Ann Hedrick determined that they could no longer afford to make monthly mortgage payments to Astoria Federal Savings and Countrywide Home Loans, Inc., the lenders secured by first and second priority liens on their residence. To remedy this problem, they applied for a new loan from NovaStar Mortgage, Inc., which agreed to make them a loan of $148,000 on terms that would substantially lower their monthly payments.

The closing of the loan by NovaStar to Debtors took place on December 4, 2003 in the offices of McClain & Merritt, P.C. Scott Mills, an attorney with that firm, closed the loan. At the closing, the Hedricks executed a document showing their receipt of closing documents (Document 19 - Exhibits filed by NovaStar, Exhibit 8, page 32) in which they acknowledged that McClain & Merritt, P.C. represented only NovaStar.

At the closing, Debtors executed and delivered to Mr. Mills, as NovaStar's agent, a security deed in favor of NovaStar conveying legal title to Debtors' residence located in Cobb County, Georgia in exchange for a loan in the amount of $148,000. They executed a closing statement (Document 19 - Exhibits filed by NovaStar, Exhibit 8, page 30) and a document informing them of their right to rescind the transaction, each of which stated in part: "If you cancel the transaction, the mortgage/lien/security interest is also cancelled." (Document 19 - Exhibits filed by NovaStar, Exhibit 9, page 34.)

The closing statement, executed by the Hedricks, shows that the proceeds of the loan were to be used to pay off two prior loans to Astoria and Countrywide. (Document 19, Exhibit 8, p. 30.) The security deeds held by Astoria and Countrywide were the only liens against the residence. NovaStar agreed to make the loan only on condition that it would be secured by a first priority lien on the residence. By delivering the security agreement to Mr. Mills and executing the closing statement, the Hedricks acknowledged their agreement with NovaStar that it was to have a first priority lien on their residence.

The proceeds of NovaStar's loan were sufficient to pay off the two prior loans and to pay most of the closing costs. Debtors received none of the loan proceeds and had no control over the loan proceeds. Debtors had three days under federal law within which to cancel the transaction. They did not do so.

Defendant filed an affidavit of Mr. Mills (document no. 21) in which he stated that it was the practice of his firm to deliver payoff checks by overnight delivery on the "Disbursement Date," which in this case was December 10, 2003. His firm sent by Federal Express on December 10, 2003, a check payable to Astoria in the amount of $112,808.75 and a check to Countrywide in the amount of $31,944.38. The balance of the loan proceeds in the amount of $3,246.87 was used to pay closing costs. Defendant filed a second affidavit of Mr. Mills (document no. 36) showing that the checks payable to Astoria and Countrywide cleared his firm's escrow account on December 12, 2003.

In his first affidavit, Mr. Mills further averred that on December 10, 2003, a "check was written to the Clerk of the Superior Court in the amount of $444.00 for the intangibles tax" and "in the amount of $38.00 for recording fees." He further stated that "in accordance with the common practice for his office, the Security Deed was sent to the Cobb County Superior Court Clerk via regular mail together with the intangibles tax check and the recording check issued on the Disbursement Date." These statements, made in the passive voice, do not resolve the issue of precisely when Mr. Mills mailed the deed and the checks to the Superior Court Clerk.

The Superior Court Clerk marked the security deed in favor of NovaStar as "filed and recorded" on January 7, 2004. The security deeds in favor of Astoria and Countrywide were cancelled of record on January 22, 2004. Debtors filed this Chapter 7 case on April 5, 2004, eighty-nine days after the recording of NovaStar's security deed.

Section 547(b) of the Bankruptcy Code, dealing with preferences, provides as follows:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made—
>
> (A) on or within 90 days before the date of the filing of the petition; or
>
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
>
> (5) that enables such creditor to receive more than such creditor would receive if—
>
> (A) the case were a case under chapter 7 of this title;
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title[.]

Section 547(c) establishes defenses to a claim that a transfer is avoidable as a preference. In its answer, Defendant raised defenses under subsection (c)(1) and (c)(2) but has apparently abandoned the (c)(2) defense, which, in the context of this case, is without merit anyway. Section 547(c)(1) provides:

> (c) The trustee may not avoid under this section a transfer—
>
> (1) to the extent that such transfer was—
>
> (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
>
> (B) in fact a substantially contemporaneous exchange[.]

Under section 547(g), Plaintiff has the burden of proving facts to satisfy the elements of his claim under subsection (b), and Defendant has the burden of proving facts to establish its affirmative defense under subsection (c)(1). The subrogation and earmarking defenses raised by Defendant are not affirmative defenses but instead attack Plaintiff's contention that he has proved all of the elements of a voidable preference required by section 547(b).

A claim under section 547(b) that a defendant has received a voidable preference has a total of seven elements that a trustee must prove. NovaStar does not contest the first three elements, which require the trustee to show (1) a transfer (2) of property in which the debtor had an interest (3) for the benefit of the

transferee. The word "transfer" is defined very broadly in section 101(54) of the Bankruptcy Code:

> "transfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption[.]

The fourth element is that the transfer must have been for or on account of an antecedent debt owed by the debtor. In other words, the debtor must have been liable on the debt prior to the transfer. On December 4, 2003, the Hedricks signed the note and security deed in favor of NovaStar and delivered those documents to Mr. Mills, NovaStar's attorney. Plaintiff argues that the recording of the NovaStar security deed on January 7, 2004 constituted a preferential transfer with respect to the antecedent debt incurred on December 4.

The fifth element requires a showing that the debtor was insolvent when the transfer. If the transfer took place within the 90-day period preceding the petition date, Debtors are presumed to have been insolvent, 11 U.S.C. § 547(f), and Defendant does not dispute that Debtors were insolvent during the 90-day period preceding the filing of the Chapter 7 petition. Insolvency is irrelevant if the transfer took place prior to January 6, 2004, which was the ninetieth day before the petition date.

The sixth element, that transfer must have occurred no more than 90 days prior to the petition date, is likewise a function of the date of the transfer. (There is no contention that NovaStar was an insider of Debtors, which would have extended the preference period to one year.)

The seventh and last element of a voidable preference requires Plaintiff to show that the transfer enabled Defendant to receive more than it would receive in a Chapter 7 case. In the typical case, this element is not contested because a defendant in a preference action almost always received more from the transfer than it would receive in a Chapter 7 case had the transfer not been made and the creditor had received payment of the debt in accordance with the Bankruptcy Code.

In his brief, Plaintiff argues that the residence is the only asset of this estate that could be liquidated to pay creditors' claims and that Debtors scheduled the value of their assets at about $122,000 less than the aggregate amount of scheduled liabilities. These arguments are not a substitute for proof. In his statement of facts not in dispute, Plaintiff made no mention of values of assets available to pay creditors or the amounts of allowed claims of creditors or of projected allowed claims. Plaintiff failed to produce any evidence showing the absence of a dispute about the facts necessary to establish this element. Although Defendant may have given Plaintiff a helping hand by introducing a copy of the schedules, there is no evidence to show that Defendant would agree with the value of the residence assigned by Debtors, what other assets of the estate the Trustee may have uncovered or

what claims have been filed in the case. (If no other creditor held an allowed claim, the amount Defendant would receive in a Chapter 7 case would arguably equal what it received as a result of the transfer, even if there were no assets other than the residence.)

To prove the fourth, fifth, and sixth elements of a voidable preference, Plaintiff must prove that the transfer of an interest in Debtors' residence occurred on or after January 6, 2004. Section 547(e) is the touchstone for determining when a potentially avoidable transfer is deemed to have been made for purposes of section 547. It provides in relevant part:

> (e)(1) For the purposes of this section—
>
> > (A) a transfer of real property other than fixtures, but including the interest of a seller or purchaser under a contract for the sale of real property, is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee;
> >
> > . . .
>
> (2) For the purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made—
>
> > (A) at the time such transfer takes effect between the transferor and the transferee, if

> such transfer is perfected at, or within 10 days after, such time, . . . ;
> (B) at the time such transfer is perfected, if such transfer is perfected after such 10 days; or
> (C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of—
>
> (I) the commencement of the case; or
> (ii) 10 days after such transfer takes effect between the transferor and the transferee.

. . .

Thus, for purposes of section 547, a transfer of an interest in the property to NovaStar is deemed to have been made on the date that the transfer was effective between the Hedricks and NovaStar provided that within ten days after the effective date, the transfer was perfected as set forth in subsection 547(e)(1). Otherwise, the transfer is deemed to have been made on the perfection date. Subsection (e)(1)'s definition of perfection does not involve the same elements of perfection of a lien against real estate under state law, and the two concepts should not be confused. Nonetheless, state law governs the resolution of the two issues presented here by section 547(e) – first, when the transfer of an interest in the property was first effective between the parties and, second, when a bona fide purchaser of the property could not have obtained an interest in the property equal to or superior to that possessed by NovaStar.

By delivering the security deed in favor of NovaStar to Mr. Mills as NovaStar's agent at the closing of the

loan on December 4, 2003, the Hedricks conveyed to Defendant an interest in the residence, subject to their right to cancel the transaction. As between the parties themselves, delivery of a deed transferring an interest in real property is valid and binding, "absent evidence of fraud, or duress, or some other coercive action." *Lionheart Legend, Inc. v. Norwest Bank Minnesota Nat. Ass'n*, 253 Ga. App. 663, 667, 560 S.E.2d 120, 124 (Ga. App. 2002); Ga Code Ann. § 44-14-63 and §44-2-2(c). Hence, the transfer was effective between the parties on December 4, 2003.

Plaintiff contends that the recording of the security deed on January 7, 2004 perfected a transfer of Debtors' residence to NovaStar. But the date on which a security deed becomes effective against a bona fide purchaser is the date on which it is filed, not the date on which it is recorded. Ga. Code Ann. § 44-2-2(b); 2 Pindar's Georgia Real Estate Law and Procedure, § 21-18, pp. 601-02 (6th ed. 2004). The parties agree on the recording date, and the Clerk's stamp applied to the security deed says "filed and recorded" on January 7, 2004. Nonetheless, it is possible to read Mr. Mills' affidavit as asserting that he mailed the deed to the Clerk on or shortly after the Disbursement Date, from which it might be presumed that the Clerk received the deed in December. In any event, the parties did not address this issue, and neither side has demonstrated an absence of an issue of fact as to when the security deed was actually received by the Cobb County Superior Court Clerk.

The filing date issue can be ignored, however, because there is a bigger fly in Plaintiff's preference ointment – the doctrine of equitable subrogation. The

doctrine of equitable subrogation has been a part of the fabric of Georgia law for more than a century. The Georgia Supreme Court first used the term "equitable subrogation" in *Merchants & Mechanics Bank v. Tillman*, 106 Ga. 55, 31 S.E. 794 (Ga. 1898). After reviewing the general law of subrogation, the Supreme Court continued as follows:

> This rule, it will be observed, distinctly recognizes the right of one parting with his money to expressly stipulate that he shall be substituted for and occupy the position of another, whose rights in the premises he seeks to acquire; and all the authorities above cited agree that a special contract of this nature, whenever it contemplates what is commonly known as "conventional subrogation," is perfectly legitimate and enforceable. . . . Thus, *"one who advances money to pay off an incumbrance, upon an agreement with the debtor that the security shall be assigned to him, or a new one given to him, will be subrogated to the rights of the incumbrancer; and, if the new security turns out to be defective, he will be substituted to the benefit of the prior incumbrance, unless the superior or equal equities of others would be prejudiced thereby."* 24 Am. & Eng. Enc. Law, 292-294. The theory upon which a court of equity proceeds, in an instance such as that just cited, would seem to be that, where one expressly contracts with a debtor for security which will secure, the fact that he does not actually get it is immaterial, unless equal or superior rights of third persons have intervened; for, as against the debtor

> himself and all parties whose rights will not be injuriously affected, the contract between him and the person in good faith advancing his money should be given effect, and consequently that will be considered done which ought to have been done. In other words, such person will be deemed to occupy the situation in which he would have been placed had the contract been executed in strict conformity to the express agreement between the parties, and his rights will be measured accordingly, whenever protection of him does not also involve a disregard of the rights, legal or equitable, of others concerned.

Id. at 55-56.

In *Tillman,* Jefferson had purchased real property from Larned and had given Larned a security deed to secure a purchase money loan, which was recorded. Later, Jefferson secured a debt to Merchants and Mechanics Bank with a second security deed on the property. Jefferson then borrowed from Tillman to pay off his debt to Larned with the understanding that Tillman was to obtain a first priority security deed on the property. The transaction closed, and the security deed in favor of Larned was marked satisfied in the public records with Tillman's approval and a security deed in favor of Tillman was recorded. Tillman had not searched the public records before making the loan to Jefferson. Had he done so, he would have found the second priority security deed in favor of the bank. Further, Tillman could have obtained an assignment of Larned's deed instead of consenting to its cancellation but did not do so. Based on constructive

notice of its deed and Tillman's failure to take an assignment of the prior deed, the bank contended that it held the first priority security deed on the property.

The Supreme Court rejected the bank's arguments, holding that only "culpable negligence" of a party in Tillman's position would bar equitable relief and that any doubt on the point should be decided in favor of the party claiming equitable relief. *Id.* at 60-61. Failing to check the public record and failing to obtain an assignment of Larned's position, the Court held, did not constitute negligence, let alone acts of culpable negligence.

In *Flournoy Plumbing Co. v. Home Owners Loan Corp.*, 181 Ga. 459, 182 S.E. 507 (1935), the Supreme Court upheld application of the doctrine of equitable subrogation against a judgment creditor whose lien was recorded after the filings of a purchase money security deed and tax liens but before the filing of a deed to secure a loan, the proceeds of which were used to pay off the first security deed and tax liens. The Supreme Court's most recent reaffirmation of equitable subrogation was in *Davis v. Johnson*, 241 Ga. 436, 246 S.E.2d 297 (1978). In that case, a bank held a security deed from Johnson to secure a loan. Johnson sold the property to Davis, and Davis obtained a new loan from the same bank to pay the purchase price. Unbeknownst to Davis and the bank, a judgment creditor of Johnson filed a judgment lien after the sale contract was executed but prior to the closing of the sale. The bank subsequently cancelled its security deed and thereafter discovered the judgment lien. The Supreme Court held that the cancellation of a security deed could be set aside so that in effect the

bank became subrogated to its own revived security deed so as to have priority over the judgment lien.

NovaStar paid the debts to Astoria and Countrywide in full as of December 12, 2003 with the understanding and agreement of Debtors that in doing so, it was to have the first priority security interest on the residence. Under the doctrine of equitable subrogation, NovaStar became subrogated to the lien positions of Astoria and Countrywide the instant that the checks drawn on its attorney's trust account and payable to the prior lenders cleared. Thus, NovaStar held the first priority lien against the property as of the time of the payoffs.

The issue presented under section 547(e) is whether under Georgia law, a bona fide purchaser could have obtained title to the residence superior to the interest held by NovaStar subsequent to the time that the payoff checks cleared on December 12, 2003 and prior to the recording of NovaStar's own security deed on January 7, 2004.

The words "bona fide" mean "the absence of all knowledge of fraud, deceit or coercion--in short of everything which would show bad faith." *Brown v. Driggers,* 62 Ga. 354 (1879). To be a bona fide purchaser, one must pay a fair value for the property purchased. A bona fide purchaser, like any purchaser, takes subject to liens of record and liens of which the purchaser has actual knowledge.

> The general rule in Georgia is "that when property is transferred to one for value, the transferee not having actual notice of any lien

> against the property, and no lien being recorded, he takes the property free of the lien. But under our recording statutes, if the lien is properly recorded so as to give constructive notice of its existence to all would-be transferees, then the transferee has notice of the lien, and the transferred property in his possession is subject to the lien." *Kilgore v. Buice*, 229 Ga. 445, 448, 192 S.E.2d 256 (1972).

Matter of Fulton Air Service, 254 Ga. 649, 650, 333 S.E.2d 581, 582-83 (1985).

A hypothetical bona fide purchaser of the Debtor's residence on and after December 12, 2003 and on or before January 7, 2004 would have had constructive notice of the security deeds in the name of Astoria and Countrywide. As the Georgia Supreme Court pointed out in *Fulton Air Service*, the test is an objective one: a properly recorded lien constitutes constructive notice. The fact that a purchaser could not have known by examining the public record that NovaStar, and not Astoria and Countrywide, held the liens is irrelevant. Under the doctrine of equitable subrogation, NovaStar was subrogated to the lien rights of the prior lenders because it paid the debts owed to those lenders with the understanding with the Hedricks that it would have the first priority lien on the residence. Hence, a bona fide purchaser could not have obtained an equal or superior interest to that held by NovaStar after the checks to Astoria and Countrywide cleared on December 12, 2003, any more than he could have obtained an interest superior to the liens of Astoria and Countrywide prior to December 12, 2003. Consequently, the transfer of an interest in the

residence to NovaStar was perfected, within the meaning of section 547(e)(1)(A), on December 12, 2003. Because only eight days passed from the closing to the date of perfection, the transfer of an interest by the Hedricks to NovaStar is deemed to have been made on December 4, 2003. 11 U.S.C. § 547(e).

Because NovaStar is deemed to have had a perfected security interest in the residence beginning on December 4, 2003, the recording of its security deed on January 7, 2004 was not a "transfer" for bankruptcy purposes. Recall that a "transfer" is a "mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property . . . ." The Hedricks had already parted with the interest they transferred to NovaStar in December, many days before NovaStar's security deed was recorded (and perhaps filed) on January 7, 2004. Upon the filing and recording of its security deed, NovaStar obtained no greater interest in the property than it already had, and the Hedricks did not dispose of or part with an interest in their residence that they had not already transferred by operation of the law of equitable subrogation. In the absence of a parting of an interest in property by the Hedricks, there was no "transfer" within the meaning of section 101(54) of the Bankruptcy Code. For purposes of perfection under section 547(e)(1), the filing and recording of NovaStar's security deed merely substituted that security deed for Astoria's and Countrywide's security deeds without changing the respective interests of NovaStar and the Hedricks in their residence.

Because the transfer of an interest in Debtors' property to NovaStar is deemed to have occurred on December 4, 2003, Plaintiff cannot prove three elements of a voidable preference. The fourth element (payment of an antecedent debt) and the sixth element (a transfer within 90 days of the petition date) never existed because the transfer is deemed to have been contemporaneous with the creation of the debt on December 4, 2003. Even if another transfer to NovaStar were deemed to have taken place on January 7, 2004, Plaintiff cannot prove the seventh element that NovaStar received more from that transfer than it would in the Chapter 7 case. NovaStar's security interest in the property was perfected under Georgia's law of equitable subrogation as well as under section 547(e) from December 12, 2003 forward, and consequently it holds a secured claim in the bankruptcy case that the Trustee cannot successfully challenge. The fifth element (insolvency) fails because Plaintiff relied on the presumption of insolvency.

Plaintiff advances several arguments in an unsuccessful effort to show that a bona fide purchaser would have been able to obtain an interest in the property equal or superior to the interest that NovaStar had between December 12, 2003 and January 7, 2004.

Plaintiff's primary argument is that a bona fide purchaser takes free of an unrecorded interest of which it had no notice, that NovaStar's security deed was unrecorded and, therefore, that a bona fide purchaser would have acquired Debtors' residence free of any interest that NovaStar had. To reach this conclusion, Plaintiff posits that in examining the chain

of title, a bona fide purchaser would have discovered the unsatisfied security deeds, would have made an inquiry of Astoria and Countrywide and would have learned that the loans were paid in full, thereby "proving that the Prior Lienholders' security deeds were unenforceable." Plaintiff's Supplemental Brief (Document No. 41). He does not assume that the purchaser would have made an inquiry of the owners. At that point, Plaintiff asserts, a bona fide purchaser would take the property with an expectation that no enforceable encumbrance of record would exist.

Implicit in Plaintiff's argument is a contention that the Court is authorized to assume facts that Plaintiff selects and that are not in evidence in order to decide the dispute. Plaintiff has not shown and could not show that a purchaser of real estate in the factual setting presented would invariably find out that the prior loans had been paid in full but would never discover in the process the existence of NovaStar's security deed. The outcome of any case can be altered by assuming "facts" that, considered alone, create a claim or undermine a defense. Section 547(e)(1)(A) tests perfection by reference to a hypothetical bona fide purchaser of the property. But that is as far as the hypothetical goes. The only knowledge chargeable or attributable to a hypothetical bona fide purchaser is what the public record shows. In a case with a real bona fide purchaser, that purchaser's personal knowledge and actions might be relevant, but a hypothetical purchaser knows only what is on the public record and does not make limited inquiries of real persons having other information. If such assumptions by a plaintiff were permitted, the defendant could advance his own set of "facts" about

the hypothetical bona fide purchaser's inquiries. Plaintiff's methodology would result in endlessly stacking of the evidentiary deck as each side assumes a factual circumstance to counter one assumed by the other.

A bona fide purchaser, real or hypothetical, would be presumed to know the law and therefore to know that the mere fact that loans secured by the prior deeds had been paid in full would not eliminate the possible existence of a new lender subrogated to the rights and priorities of the prior lenders. Consequently, even if the bona fide purchaser made Plaintiff's limited inquiry and learned that the prior loans had been paid, he could not use the fact of payoff as a proxy for the absence of a lien. The simple solution to the problem every purchaser faces when a title examination reveals an unsatisfied security deed is to insist on the recording of satisfaction of the prior security deed before paying any new value to the sellers. Plaintiff did not assume such a prudent course of action for the obvious reason that it would defeat his claim, just as he did not assume that a purchaser would have inquired of the Hedricks whether there was any unrecorded lien against the property and that the Hedricks would have answered honestly.

Plaintiff's legal conclusion is also in error. He posits that once a loan secured by real property is paid in full, the security deed, though still of record, is completely unenforceable for all purposes. This conclusion collides head-on with the doctrine of equitable subrogation. Even if Astoria and Countrywide, having been paid in full, could not themselves have enforced covenants in their respective

security deeds, an entity entitled to rely on the doctrine of equitable subrogation would have enjoyed the same lien position that Astoria and Countrywide enjoyed. To adopt Plaintiff's legal conclusion would be to ignore Georgia law as laid down by its Supreme Court in cases applying the doctrine of equitable subrogation.

Plaintiff has pointed out that all of the equitable subrogation cases involved intervening or existing liens against the properties at issue. None involved a bona fide purchaser. This is a meaningless distinction, however. The doctrine is based on equity. It strives to reach a result that does not disappoint expectations. In the case of an intervening judgment lien creditor, for example, that creditor has constructive notice of the security deed securing the loan that is later paid off; he knows he is in second place. The subrogation of a new lender to the lien of prior lender paid off with the new loan does not upset the judgment creditor's expectation of his place in the priority scheme. Similarly, a hypothetical bona fide purchaser of property on which there is an outstanding security deed has no legally cognizable expectation that he will acquire the property free and clear of the lien of that deed.

Citing *Wilkins v. Gibson*, 113 Ga. 31, 30 S.E. 374 (1901), Plaintiff points out that equitable subrogation protects a party with a defective security instrument only "if not chargeable with culpable and inexcusable neglect" and if the holder of a superior or equal lien would not be thereby prejudiced. *Id.* at 382. Based on this holding, Plaintiff makes his next argument that NovaStar was guilty of culpable and inexcusable

neglect in failing to record its security deed promptly after it was executed.

This argument is also without merit. Nothing in the record shows any neglect by NovaStar, much less "culpable and inexcusable" neglect. Plaintiff contends that the act constituting culpable negligence was NovaStar's failure to file its security deed within the ten-day period imposed by section 547(e). This argument loses sight of the fact that NovaStar would have had to have been clairvoyant in late 2003 and early 2004 to know that section 547(e) would be implicated. Indeed, section 547(e) imposes no duty on a lender to record a security deed within ten days of the date on which the transaction is effective between the parties. Therefore, a delay in recording a security deed cannot be negligence because negligence is the tort of unreasonably failing to perform a legal duty. Nor was it culpable negligence to fail to take an assignment of the positions of the former lenders, as the Georgia Supreme Court in *Tillman* expressly stated. Retroactively superimposing the ten-day period set forth in section 547(e) on state law to support a tort of culpable negligence would offend federalism by disregarding Georgia law concerning the priority of liens and interest in property.

Waiting too long to file a security deed may have adverse consequences for the party holding the unfiled security instrument, but its dilatory conduct would have an adverse effect only as to its own rights. Thus, the Georgia Supreme Court in holding in *Wilkins* that culpable and inexcusable negligence would alter the equitable valence must have been referring to conduct

that harmed another entity. Plaintiff cannot show harm to anyone.

A hypothetical bona fide purchaser could not be said to be prejudiced by the delay in the recording of a security deed because being charged with the knowledge of the law of equitable subrogation and of the outstanding security deeds, he could not presume that the debt had not been refinanced. Hence, a hypothetical bona fide purchaser could no suffer damage by the subrogation of NovaStar to the former lenders' lien positions. In short, Plaintiff has not shown a duty owed by NovaStar to a hypothetical bona fide purchaser, an unreasonable breach of that duty by NovaStar or damages suffered by the hypothetical purchaser.

Finally, Plaintiff attacks the doctrine of equitable subrogation as a nefarious method of defeating a preference. For example, he asserts that Defendant "may not rely on the doctrine of equitable subrogation to mediate its tardy and preferential recordation of the Security Deed." Plaintiff's Supplemental Brief, p. 4 (Doc. No. 41). Similarly, he asserts that "to allow a party to disregard the well known time limits for the relation-back recording as set forth in 11 U.S.C. § 547 . . . would prejudice the 'superior or equal equities' of the bona fide purchaser . . . ." Plaintiff's Supplement Brief, p. 5 (Doc. No. 41). These arguments are incoherent. In the first argument quoted above, Plaintiff commits the logical error of begging the question of when the transfer was made. Because the transfer is deemed to have been made on December 4, 2003, more than 90 days prior to the petition date, it was not preferential. As to the second argument, this

Court is not disregarding, or permitting NovaStar to disregard, the time limits imposed by section 547 on equitable or any other grounds. Plaintiff loses, not because anyone is disregarding section 547 to "mediate" a preferential recording of a deed, but rather because the transfer was not a voidable preference in the first place.

Neither party has remarked on the effect, if any, under the doctrine of equitable subrogation, of the difference between the aggregate amount of debt owed to Astoria and Countrywide and the slightly larger amount of NovaStar's loan. Consequently, any contention that the difference in loan amounts would make a difference in the analysis under the doctrine of equitable subrogation is waived It is difficult to construct an argument that the differential in the loan amounts is material. A holder of a second priority security deed is always at risk to a larger loan secured by the first position if the first priority security deed has a dragnet clause or a future advances clause. Likewise, a bona fide purchaser would have nothing to complain about because he can protect himself by obtaining a satisfaction of the prior security deed before he closes the purchase.

It is not necessary to comment on NovaStar's other two defenses, except to say that standing alone, they would be suspect.

For these reasons, it is

ORDERED that Plaintiff's motion for summary judgment is DENIED, and Defendant's motion for summary judgment is GRANTED.

This 31st day of August 2005.

/s/
JAMES E. MASSEY
U.S. BANKRUPTCY JUDGE

APPENDIX G

**IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT
OF GEORGIA ATLANTA DIVISION**

**CIVIL ACTION FILE
NUMBER 05-CV-3123-TCB**

[Filed February 23, 2007]

NEIL C. GORDON, Trustee for the Estate of Santosh K. Sharma,	)
Plaintiff/Appellant,	)
v.	)
ABN AMRO MORTGAGE GROUP, INC.,	)
Defendant/Appellee.	)

ORDER

Before the Court is Plaintiff's appeal of the Bankruptcy Court's October 31, 2005 order denying Plaintiff's motion for summary judgment and granting Defendant's motion for summary judgment.

In its appellate capacity, a district court may "affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings." Fed. R. Bank. P. 8013. The Court is bound by the bankruptcy court's findings of fact unless they are clearly erroneous, but the bankruptcy court's conclusions of law are subject to *de novo* review. *In re Calvert*, 907 F.2d 1069, 1071 (11th Cir. 1990).

The Court has carefully reviewed the entire record and has carefilly examined the Bankruptcy Court's order. The Court finds that the order is thorough, well-reasoned, and correct in every respect. Accordingly, the judgment of the Bankruptcy Court is affirmed.

The CLERK is DIRECTED to terminate all pending submissions and DISMISS THIS APPEAL.

IT IS SO ORDERED this 23rd day of February, 2007.

/s/
Timothy C. Batten, Sr.
United States District Judge

APPENDIX H

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

BANKRUPTCY CASE NO. 03-68468-MGD
CIVIL ACTION FILE NUMBER
NO. 1:05-cv-3123-TCB

[Filed February 23, 2007]

NEIL C. GORDON,	)
	)
Appellant,	)
	)
vs.	)
	)
ABN Amro Mortgage Group, Inc.,	)
	)
Appellee.	)
	)

JUDGMENT

This action having come before the court, Honorable Timothy C. Batten, Sr., United States District Judge, for consideration of the appeal of the bankruptcy order entered 11/1/05, and the court having rendered its decision, it is

Ordered and Adjudged that the order of the bankruptcy court is **affirmed** and the appeal is **dismissed.**

Dated at Atlanta, Georgia this 23rd day of February, 2007.

JAMES N. HATTEN
CLERK OF COURT

By: s/Melissa Shalongo
Deputy Clerk

Prepared, Filed, and Entered
in the Clerk's Office
February 23, 2007
James N. Hatten
Clerk of Court

By: s/Melissa Shalongo
Deputy Clerk

APPENDIX I

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

Chapter 7 Case No. 03-68468
Adversary Proceeding No. 04-06438

[Filed October 31, 2005]

In re:	)
	)
SON R. SHARMA and	)
SANTOSH K. SHARMA	)
	)
Debtors	)
	)
NEIL C. GORDON, Trustee	)
	)
Plaintiff,	)
	)
vs.	)
	)
ABN AMRO MORTGAGE	)
GROUP, INC.	)
	)
Defendant	)
	)

ORDER GRANTING DEFENDANT'S MOTION FOR SUMMARY JUDGMENT AND DENYING PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

This matter is before the Court on the cross motions for summary judgment filed by Plaintiff Neil C. Gordon, Chapter 7 Trustee for the Estate of Santosh K. Sharma ("Trustee") and Defendant ABN Amro Mortgage Group, Inc. ("Defendant"). Oral argument on the motions was held on July 21, 2005 and after considering all the materials submitted[1] and the arguments of the parties, Defendant's Motion for Summary Judgment will be GRANTED and Trustee's

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[1] Plaintiff's Motion for Summary Judgment filed by Neil C. Gordon (A.P. Docket #12); Memorandum of Law in Support of Plaintiff's Motion for Summary Judgment (A.P. Docket #13); Response to Motion (Defendant's Reply to Plaintiff's Motion for Summary Judgment and Defendant's Cross-Motion for Summary Judgment, Reply brief of Defendant in Opposition to Plaintiff's Motion for Summary Judgment and in Support of Defendant's Cross-Motion for Summary Judgment and Affidavit, Attachments to Affidavit) (A.P. Docket #17); Statement of Undisputed Facts Offered in Support of Plaintiff's Motion for Summary Judgement (A.P. Docket #18); Reply to Response (Plaintiff's Reply to Defendant's Reply (sic) to Plaintiff's Motion for Summary Judgment and Defendant's Cross Motion for Summary Judgment) (A.P. Docket #19); Statement of Undisputed Facts (Plaintiff's Reply to Defendant's Statement of Material Facts as to Which There is no Genuine Issue) (A.P. Docket #20); Response to Motion (Defendant's Reply to Plaintiff's Statement of Material Facts Not in Dispute Offered in Support of Plaintiff's Motion for Summary Judgment) (A.P. Docket #21); Supplemental Brief for Defendant's Cross-Motion for Summary Judgment) (A.P. Docket #26); Supplemental Memorandum of Points and Authorities in Support of Cross-Motion for Summary Judgment and in Opposition to Plaintiff's Motion for Summary Judgment) (A.P. Docket #29).

Motion for Summary Judgment will be DENIED. A separate judgment will be entered.

FACTS

The material facts are undisputed. On June 18, 2003 ("the petition date"), Debtor Santosh K. Sharma filed a joint Chapter 7 case with her spouse, Som R. Sharma (Case No. 03-68468). Trustee was appointed interim trustee and became the permanent case trustee on July 23, 2003 at the conclusion of the meeting of creditors held pursuant to 11 U.S.C.§ 341(a). As of the petition date, Debtor Santosh K. Sharma owned an undivided one-half interest in a residence located at 1960 Sugar Lake Court, Lawrenceville, Georgia 30043-5050. The remaining one-half interest was owned by a non-debtor, Sanjiv Gupta.

On May 20, 2003, Debtor Santosh Sharma and non-debtor Gupta refinanced the debt secured by this residence. The new loan was obtained from Defendant and was in the amount of $225,000. The loan was to be secured by a first priority deed to secure debt and the proceeds from the loan were used to pay off the existing first and second liens on the residence: Union Planter's Bank ($194,110.06) and Atlantic States Bank ($27,860.85). The Union Planter's Bank lien secured debt owed by Debtor; the Atlantic States Bank lien secured debt owed by Gupta. The security deed to Defendant was executed by Debtor and Gupta at the closing on May 20, 2003.

The three day rescission period for the loan expired at midnight on Friday, May 23, 2003, the Friday

preceding the Memorial Day holiday. Disbursements were made to Union Planter's Bank and Atlantic States Bank by checks which were sent by Federal Express on the next business day after the rescission period, Tuesday, May 27, 2003. On May 28, 2003, the closing attorney sent the security deed in favor of Defendant to The Gwinnett County Clerk of Superior Court together with checks for the recording fee and intangibles tax which were due.[2]

The date of the receipt of the security deed by Gwinnett County for recording is not in evidence. Defendant's security deed was recorded on June 10, 2003. At the time it was recorded, the security deeds of Union Planter's Bank and Atlantic States Bank were still of record in Gwinnett County. On the Petition Date, there were three security deeds of record on Debtors' property. On June 23, 2003, the cancellation of Union Planter's Bank security deed was recorded and on June 26, 2003, the cancellation of Atlantic States Bank's security deed was recorded.

LEGAL ISSUES

The Trustee commenced this adversary proceeding on July 29, 2004, seeking to avoid as a preference the transfer by Debtor to Defendant of the security interest in her residence. The Trustee's action is premised on 11 U.S.C.§ 547(b) which provides:

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[2] The method by which the security deed was transmitted is not in evidence. The transmittal "letter" does not indicate whether it was hand delivered, mailed, sent by courier or otherwise.

Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property–

(1) to or for the benefit of a creditor;
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
(3) made while the debtor was insolvent;
(4) made –
(A) on or within 90 days before the date of the filing of the petition;
. . . .
(5) that enables such creditor to receive more than such creditor would receive if –
(A) the case were a case under chapter 7 of this title;
(B) the transfer had not been made; and
(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

Critical to Trustee's complaint is the determination of when the transfer occurred between Debtor and Defendant. Transfers of interests in real property are governed by section 547(e), which provides that

(1) For purposes of this section –
(A) a transfer of real property other than fixtures, but including the interest of a seller or purchaser under a contract for the sale of real property, is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an

interest that is superior to the interest of the transferee; ....

(2) For purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made —

(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time, except as provided in subsection (c)(3)(B);[3]

(B) at the time such transfer is perfected, if such transfer is perfected after such 10 days; or

(C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of–

(i) the commencement of the case; or

(ii)10 days after such transfer takes effect between the transferor and the transferee.

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[3] Section 547(c)(3) exempts purchase money security interests from Trustee's avoidance powers under § 547(b) where the security interest is perfected within 20 days after the debtor receives possession. Some courts have held that § 547(c)(3) is inapplicable in the refinancing context. *Patterson v. Irwin Mortg. Corp. (In re Patterson)*, 330 B.R. 631, 2005 Bankr. LEXIS 1850 (Bankr. E.D. Tenn. 2005) (§ 547(c)(3) inapplicable in refinancing context); *Palmer v. Key Bank USA (In re Conley)*, 318 B.R. 812, 816-17 (Bankr. E.D. Ky. 2004) (Section 547(c)(3) was irrelevant to refinancing loan, as it "applies only to loans made to enable the debtor to acquire the collateral."); *Sticka v. U-Lane-O Credit Union (In re McKay)*, 1999 Bankr. LEXIS 1908, 6 (Bankr. D. Or. Feb. 1, 1999)(automobile refinancing loan not governed by § 547(c)(3)).

(3) For purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred.

In essence, Trustee argues that the transfer by Debtor of a security interest in the residence took place on May 20, 2003 but was not perfected until the security deed was recorded on June 10, 2003,[4] beyond the ten day period allowed by 11 U.S.C. § 547(e)(2)(A). Therefore, the transfer is deemed to have occurred on the recording date under 11 U.S.C. § 547(e)(2)(B). Thus, it is a payment on an antecedent debt since the debt was created when the loan was funded.

Defendant raises a number of defenses, including contemporaneous exchange (11 U.S.C. § 547(c)(1)) and equitable subrogation under Georgia law. Both of those defenses are grounded in a determination that the transfer of the security interest to Defendant occurred on May 27, 2003 (loan funding), the same time that the debt was created.

SUMMARY JUDGMENT STANDARD

Both parties move for summary judgment. Pursuant to Fed. R. Civ. P. 56(c), made applicable by

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[4] The date on which a security deed becomes effective against a bona fide purchaser is the date on which it is *filed*, not the date on which it is *recorded*. O.C.G.A. § 44-2-2(b); Pindar's Georgia Real Estate Law and Procedure, § 21-18, pp. 601-02 (6th ed. 2004). No evidence was introduced as to the filing date, although Defendant did show that the security deed was sent to Gwinnett County on May 28, 2003 although the deed was not recorded until June 10, 2003.

Fed. R. Bankr. P. 7056, a party moving for summary judgment is entitled to prevail if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986) (*quoting* Fed. R. Civ. P 56(c)). The parties do not dispute the material facts.

DISCUSSION OF LEGAL ISSUES

Georgia law governs this action. A determination of when the transfer of the security interest occurred under 11 U.S.C. § 547(e)(1)(A) therefore turns on when "a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee." Stated another way, if a bona fide purchaser (BFP) at the petition date could obtain title to the real estate and not be subject to Defendant's security deed, the transfer was not perfected and the Trustee wins. If the BFP could not have taken free of the security interest, Defendant wins.

At all points in time from May 20, 2003 until after this bankruptcy case was filed, there were one or more security deeds of record against Debtor's residence. At the time that Defendant's security deed was filed on June 10, 2003, the security deeds of Union Planter's Bank and Atlantic States Bank were still of record. Thus, any party acquiring the real estate between May 20, 2003 and June 10, 2003 who searched the title to the property would have found two security deeds of

record. Under Georgia's recording statutes, a party acquiring title is charged with constructive knowledge of what a search of the title records would reveal.

> The general rule in Georgia is "that when property is transferred to one for value, the transferee not having actual notice of any lien against the property, and no lien being recorded, he takes the property free of the lien. But under our recording statutes, if the lien is properly recorded so as to give constructive notice of its existence to all would be transferees, then the transferee has notice of the lien, and the transferred property in his possession is subject to the lien." *Kilgore v. Buice,* 229 Ga. 445, 448, 192 S.E.2d 256 (1972).

Matter of Fulton Air Service, 254 Ga. 649, 650, 333 S.E.2d 581, 582-83 (1985).

Under the facts of this case, a bona fide purchaser would be charged with constructive knowledge of the two recorded deeds. However, the loans which those security deeds secured had been paid in full and Defendant's security deed had not yet been filed. The Trustee argues that since the underlying loans had already been satisfied, these security deeds were of no further force and effect and therefore even if a BFP took subject to them, the BFP did not take subject to Defendant's unrecorded lien which is all that matters here. To fill this gap, the Court must examine the Georgia doctrine of equitable subrogation.

Equitable subrogation is a precept of Georgia real estate law which has its origins in a 1898 Georgia

Supreme Court case, *Merchants' & Mechanics' Bank v. Tillman*, 106 Ga. 55, 31 S.E. 794 (1898). Essentially, the doctrine provides that where the intent of the parties is to substitute one creditor's rights for the rights of the creditor that is being paid, the second creditor steps into the shoes of the first creditor as to priority and perfection. As the Georgia Supreme Court stated

> [t]his rule, it will be observed, distinctly recognizes the right of one parting with his money to expressly stipulate that he shall be substituted for and occupy the position of another, whose rights in the premises he seeks to acquire; and all the authorities above cited agree that a special contract of this nature, whenever it contemplates what is commonly known as "conventional subrogation," is perfectly legitimate and enforceable. . . . Thus, "one who advances money to pay off an incumbrance, upon an agreement with the debtor that the security shall be assigned to him, or a new one given to him, will be subrogated to the rights of the incumbrancer; and if the new security turns out to be defective, he will be substituted to the benefit of the prior incumbrance, unless the superior or equal equities of others would be prejudiced thereby." 24 Am. & Eng. Enc. Law, 292-294. The theory upon which a court of equity proceeds, in an instance such as that just cited, would seem to be that. Where one expressly contracts with a debtor for security which will secure, the fact that he does not actually get it is immaterial, unless equal or superior rights of third persons

> have intervened; for, as against the debtor himself and all parties whose rights will not be injuriously affected, the contract between him and the person in good faith advancing his money should be given effect, and consequently that will be considered done which ought to have been done. In other words, such person will be deemed to occupy the situation in which he would have been placed had the contract been executed in strict conformity to the express agreement between the parties, and his rights will be measured accordingly, whenever protection of him does not also involve a disregard of the rights, legal or equitable, of others concerned.

Tillman at 56-57.

The facts of *Tillman* involved a payoff of a first priority security deed by a new lender where a second priority security deed had also been filed. The agreement between the debtor and the new lender was that the new lender would take the place and priority of the existing first priority deed. The old first lender satisfied its security deed of record and Tillman, the new lender, without examining title, filed a new deed. The existing second lender (Merchants') argued that it was now first priority since Tillman had constructive notice of Merchants' deed and because Tillman could have taken an assignment of the existing first deed and did not. The Georgia Supreme Court rejected those arguments and held in favor of Tillman, because there was no "culpable negligence" on the part of Tillman. *Id. at 60-61.*

The Georgia Supreme Court has continued to apply this principle, most recently in *Davis v. Johnson*, 241 Ga. 436, 246 S.E.2d 297 (1978). That case involved an intervening judgment lien. Gwinnett County Bank had a purchase money security deed from Johnson. Johnson contracted to sell the property to Davis in June and in September, Davis borrowed funds from Gwinnett County Bank to pay the purchase price. The security deed given by Davis included a provision that Davis had absolute title and there were no other liens on the property. Unknown to Davis or the Bank, a judgment creditor of Johnson had recorded a judgment lien in July. When Gwinnett County Bank's security deed from Johnson was cancelled in December, the lien creditor, asserting that it held the first priority interest, sought to foreclose its lien. The Gwinnett County Bank raised the issue of equitable subrogation and sought to reinstate its cancelled security deed. The trial court held for the judgment creditor and the Georgia Supreme Court reversed and held:

> Although it may seem somewhat anomalous to allow someone to be subrogated to his own rights, we believe that the use of the subrogation doctrine under the circumstances of this case is entirely justified. As we stated in *Cornelia Bank v. First Natal. Bank,* 170 Ga 747, 750 (154 SE 234)(1930), "Subrogation . . . is of equitable origin and benevolence. It is founded upon the dictates of refined justice. Its basis is the doing of complete, essential, and perfect justice between all the parties, without regard to form, and its object is the prevention of injustice. . . The courts incline rather to extend than restrict the principle. The doctrine

> has been steadily growing and expanding in importance, and becoming general in its application to various subjects and classes of persons, the principle being modified to meet the circumstances of cases as they have arisen." *Southern R. Co. v. Overnite Transp. Co.*, 223 Ga. 825, 830 (158 SE2d 387)(1967).

241 Ga. at 439.

A dissent in the *Davis* case relied on the fact that equity should not intervene where the Bank could have protected itself by examining the title. Even under the reasoning of the dissent, the doctrine of equitable subrogation appears to be applicable here. There is no evidence of any negligence by Defendant – the security deed was sent to the County for recording on the day following the disbursement of funds – and certainly no evidence of "culpable negligence."

Thus, because Defendant was equitably subrogated to the rights of the prior lenders when it advanced the funds to pay off those debts, a BFP could not get ahead of Defendant in priority since a record search would have revealed the existence of those liens. The Trustee can have no greater rights than those of the BFP under Section 547(e) since the transfer of the interest to Defendant occurred at the time the loan was funded and the prior lienholders were paid off. A recent case in this district has applied the principles of equitable subrogation in a slightly different factual context. In *Gordon v. NovaStar Mortg. (In re Hedrick)*, 2005 Bankr. LEXIS 1923 (Bankr.N.D. Ga. August 31, 2005), Judge Massey held that a transfer of a security deed was protected by principles of equitable subrogation to

bring it outside the ninety day preference period of Section 547. The reasoning of *In re Hedrick* applies as well to this case.

The Trustee argues that equitable subrogation is inapplicable and cites several cases where courts declined to apply the principle in preference cases. These cases are distinguishable. First, none of the cases deals with Georgia's law of equitable subrogation. The Trustee relies on cases concerning Michigan's law on equitable subrogation, which has preconditions to its applicability which are not required under Georgia law. Under Michigan law, equitable subrogation is a doctrine "depending on no contract or privity, and proper to apply whenever persons other than mere volunteers pay a debt or demand which in equity and good conscience should have been satisfied by another." *Stroh v. O'Hearn*, 176 Mich. 164, 142 N.W. 865 (1913). Michigan courts have specifically excluded refinancing lenders from eligibility to be subrogated to the priority of previous security interests. *Flagstar Bank v. Charter One Bank*, 2005 Mich. App. LEXIS 2094 (Mich. Ct. App. Aug. 25, 2005) (unpublished opinion) (Refinancing lender was a volunteer where it was under no "legal or equitable duty" to the borrowers to undertake the refinancing, and therefor could not be equitably subrogated to the priority of the older mortgagee).

Georgia's equitable subrogation doctrine has no such "volunteer" bar. See *Merchants' & Mechanics' Bank v. Tillman*. The Trustee argues that Georgia law does have such a "volunteer" limitation, citing *Lee v. Arlington Peanut Co.*, 176 Ga. 816, 169 S.E. 1 (1933). However, *Lee* is distinguishable. *Lee* applied Georgia's

law of legal subrogation, and held that a mortgagee, who, without the knowledge or agreement of the mortgagor, paid third party liens against the mortgagor was not entitled to subrogation where the mortgagee was under no obligation to pay the mortgagor's debts. *Id.* In this case, Defendant agreed with Debtor to discharge the prior indebtedness and to receive a first priority security deed in exchange. Even under *Lee*, Defendant was not a "volunteer" as it was obligated to pay both of the prior lenders as part of the refinancing. *See Lee* at 819 ("Any one who is under no obligation or liability to pay the debt is a stranger, and, if he pays the debt, a mere volunteer.")(quoting *Aetna Life Ins. Co. v. Middleport*, 124 U.S. 534, 550 (1888)). To hold that Georgia's equitable subrogation doctrine excludes lenders who advance money specifically to pay prior lien holders as "volunteers" would effectively overturn the holding of *Tillman*. This court declines to do so, especially in light of the fact that *Davis*, decided after *Lee*, imposed no such "volunteer" restriction on the application of Georgia's equitable subrogation doctrine. *See Davis v. Johnson*, 241 Ga. 436.

Furthermore, the Trustee's reliance on *Boyd v. Superior Bank FSB (In re Lewis)*, an unpublished opinion of the district court applying Michigan law,[5] is not compelling. The opinion of the bankruptcy court which the district court was reviewing, although controlled by Michigan law, sought to impose a further

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[5] 270 B.R. 215, 217 (W.D. Mich. 2001) aff'd *Boyd v. Superior Bank F.S.B. (In re Lewis)*, Case No. 1:02-CV-31, Ch. 7 ST 00-03660, Adv. No. 00-88404 (W.D. Mich. 2001).

limitation on equitable subrogation found in Missouri law. 270 B.R. at 217. The bankruptcy court stated that equitable subrogation was applicable to only "extreme cases bordering on, if not reaching the level of fraud." *Lewis* at 217 (citing *Rouse v. Chase Manhattan Bank, USA, NA (In re Brown)*, 226 B.R. 39, 44 (Bankr. W.D. Mo. 1998)). The fraud limitation is part of Missouri law; Georgia law has no such limitation. *See Merchants' & Mechanics' Bank v. Tillman*, 106 Ga. 55. The district court, while noting that Missouri law was not applicable, found that controlling Michigan law also limited the applicability of equitable subrogation. Only Georgia law is applicable to this case, not the laws of any other state.[6]

At least one court has opined that an application of the doctrine of equitable subrogation to a preference action "directly circumvents Congressional intent that the exclusive meritorious defenses to a § 547(b) preference action are set forth in § 547(c)." *Guinn v. Irwin Mortg. Corp. (In re Patterson)*, 330 B.R. 631, 2005 Bankr. LEXIS 1850, *26-27 (Bankr. E.D. Tenn. 2005). This is similar to the Trustee's argument that the application of equitable subrogation makes it impossible for the Trustee to prevail in refinancing

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[6] State equitable subrogation doctrines are not fungible. In fact, Georgia's law of equitable subrogation is very forgiving in comparison to the other, more limited state doctrines described above. Under Georgia law, a party may be entitled to equitable subrogation in the absence of "culpable neglect" on its part. *Tillman*, 106 Ga. at 61. Even such a glaring oversight as failure of a lender to investigate a title for properly recorded liens does not amount to "culpable neglect." *See Id*; *Davis v. Johnson*, 241 Ga. 436.

cases such as this. However, under Georgia law, the application of the preference statute, particularly § 547(e) requires the court to look at state law to determine when a transfer is made for purposes of the preference statute. If the Bankruptcy Code mandates the application of state law and state law requires the application of equitable subrogation, it certainly cannot be said to circumvent Congressional intent to apply it.

Having determined that the transfer of the security deed from Debtor to Defendant was perfected on May 27, 2003 because no BFP could acquire an interest superior to that of Defendant after that date, the transaction qualifies as a "contemporaneous exchange for new value" and is excepted from avoidance under 11 U.S.C. § 547(c)(1).

The Defendant also raises as a defense the doctrine of "earmarking." Earmarking is the concept that a preference cannot occur unless the debtor has an interest in the property transferred. Thus, if A gives the debtor funds for the express purpose of paying a debt owed to B, no preference results because the debtor was a mere conduit and had no interest in the property transferred. Earmarking has no applicability here because the transfer which the Trustee seeks to avoid is not the transfer of the funds but the transfer of a security interest by the Debtor.

For these reason, it is

ORDERED that Defendant's Motion for Summary Judgment is **GRANTED** and Plaintiff's Motion for Summary Judgment is **DENIED**.

This 31 day of October, 2005.

/s/
Mary Grace Diehl
United States Bankruptcy Judge

APPENDIX J

UNITED STATES CODE
TITLE 11. BANKRUPTCY
CHAPTER 5--CREDITORS, THE DEBTOR, AND THE ESTATE
SUBCHAPTER III--THE ESTATE

(Effective prior to 2005 Amendments)

11 U.S.C. § 547. Preferences

(a) In this section–

(1) "inventory" means personal property leased or furnished, held for sale or lease, or to be furnished under a contract for service, raw materials, work in process, or materials used or consumed in a business, including farm products such as crops or livestock, held for sale or lease;

(2) "new value" means money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property, but does not include an obligation substituted for an existing obligation;

(3) "receivable" means right to payment, whether or not such right has been earned by performance; and

(4) a debt for a tax is incurred on the day when such tax is last payable without penalty, including any extension.

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property–

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made–

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if–

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

(c) The trustee may not avoid under this section a transfer–

(1) to the extent that such transfer was–

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange;

(2) to the extent that such transfer was–

(A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;

(B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and

(C) made according to ordinary business terms;

(3) that creates a security interest in property acquired by the debtor–

(A) to the extent such security interest secures new value that was–

(i) given at or after the signing of a security agreement that contains a description of such property as collateral;

(ii) given by or on behalf of the secured party under such agreement;

(iii) given to enable the debtor to acquire such property; and

(iv) in fact used by the debtor to acquire such property; and

(B) that is perfected on or before 20 days after the debtor receives possession of such property;

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor–

(A) not secured by an otherwise unavoidable security interest; and

(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;

(5) that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the

prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of–

(A)(i) with respect to a transfer to which subsection (b)(4)(A) of this section applies, 90 days before the date of the filing of the petition; or

(ii) with respect to a transfer to which subsection (b)(4)(B) of this section applies, one year before the date of the filing of the petition; or

(B) the date on which new value was first given under the security agreement creating such security interest;

(6) that is the fixing of a statutory lien that is not avoidable under section 545 of this title;

(7) to the extent such transfer was a bona fide payment of a debt to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that such debt–

(A) is assigned to another entity, voluntarily, by operation of law, or otherwise; or

(B) includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance or support; or

(8) if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than $600.

(d) The trustee may avoid a transfer of an interest in property of the debtor transferred to or for the benefit of a surety to secure reimbursement of such a surety that furnished a bond or other obligation to dissolve a judicial lien that would have been avoidable by the trustee under subsection (b) of this section. The liability of such surety under such bond or obligation shall be discharged to the extent of the value of such property recovered by the trustee or the amount paid to the trustee.

(e)(1) For the purposes of this section–

(A) a transfer of real property other than fixtures, but including the interest of a seller or purchaser under a contract for the sale of real property, is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee; and

(B) a transfer of a fixture or property other than real property is perfected when a creditor on a

simple contract cannot acquire a judicial lien that is superior to the interest of the transferee.

(2) For the purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made–

(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time, except as provided in subsection (c)(3)(B);

(B) at the time such transfer is perfected, if such transfer is perfected after such 10 days; or

(C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of–

(i) the commencement of the case; or

(ii) 10 days after such transfer takes effect between the transferor and the transferee.

(3) For the purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred.

(f) For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.

(g) For the purposes of this section, the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section, and the creditor or party in interest against whom recovery or avoidance is sought has the burden of proving the nonavoidability of a transfer under subsection (c) of this section.

OPPOSITION BRIEF

Supreme Court, U.S.
FILED
OCT 24 2008
OFFICE OF THE CLERK

No. 08-370

In The
Supreme Court of the United States

NEIL C. GORDON, as Trustee,
Petitioner,

v.

NOVASTAR MORTGAGE, INC.,
Respondent.

NEIL C. GORDON, as Trustee,
Petitioner,

v.

ABN AMRO MORTGAGE GROUP, INC.,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

I. Whether Petitioner has presented compelling reasons to grant the Petition where the dispositive issue in the courts below, the time of perfection of a security interest, was determined under state law as dictated by Congress in 11 U.S.C. § 547(e)(1)(A)?

II. Whether Petitioner has presented compelling reasons to grant the Petition where application of the dispositive state law renders it unnecessary to address the proper application of the substantially contemporaneous exchange defense under 11 U.S.C. § 547(c)(1), as to which there appears to be a split among the circuits?

III. Whether Petitioner has presented compelling reasons to grant the Petition where the factual circumstances and legal issues involved are unlikely to recur frequently in the future, particularly in light of changes in the credit markets and the 2005 amendment to 11 U.S.C. § 547(e)(2) that extended the grace period for perfection from 10 to 30 days?

RULE 14.1(b) STATEMENT

Pursuant to Rule 14.1(b), Respondents incorporate Petitioner's list of parties to the proceeding in the Court whose judgment is the subject of the Petition.

Pursuant to Rules 14.1(b) and 29.6, Respondents provide their corporate disclosure statement below:

As to Respondent ABN AMRO Mortgage Group, Inc.

ABN AMRO Mortgage Group, Inc. was merged out of existence on Sept 1, 2007. CitiMortgage, Inc. is its successor in interest by merger. CitiMortgage, Inc.'s parent corporation is Citibank Domestic Investment Corporation whose parent is Citibank, NA., whose parent is Citicorp Holdings Inc. The parent corporation of Citicorp Holdings Inc. is Citigroup, Inc. CitiMortgage, Inc. has no publicly held company holding its stock, as all of it is owned by its parent corporation.

As to Respondent NovaStar Mortgage, Inc.

NovaStar Mortgage, Inc.'s only parent corporation is NovaStar Financial, Inc., a publicly traded company that wholly owns NovaStar Mortgage, Inc.

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I. State law controls the dispositive issue regarding the timing of perfection pursuant to U.S.C. § 547(e)(1)(A). 8

A. Under Georgia law, Respondents, as refinancing secured lenders, were subrogated to the recorded security interests of the lenders whose loans were paid off by their refinancing loans as of the dates of such payoffs. 8

B. Under Georgia law, a third party purchaser of either of the properties would have taken such property with constructive notice of and subject to the security interests to which Respondents became subrogated 9

C. The federal cases relied on by Petitioner did not involve equitable subrogation and are entirely distinguishable. 11

II. The Court does not need to reach the application of the "substantially contemporaneous exchange" defense contained in 11 U.S.C. § 547(c)(1), because the relevant transfer was not avoidable under 11 U.S.C. § 547(b). 13

III. These cases involve relatively rare circumstances and issues that do not raise a question of national importance; future cases similar to these are even less likely to occur due to changes in the credit markets and the extension by Congress of the perfection grace period under 11 U.S.C. § 547(e)(2) from 10 to 30 days. 14

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OPINIONS BELOW

Respondents adopt Petitioner's statement of the Opinions Below. Respondents further note that in the opinions below, two bankruptcy judges, one district court judge, and the Eleventh Circuit Court of Appeals in a decision authored by Judge Edward Carnes, all reached the same conclusion with respect to the two cases that resulted in the Eleventh Circuit Opinion that is the subject of this Petition for Certiorari.

Respondents, as secured lenders that refinanced pre-existing secured loans, stand in the shoes of the pre-existing secured lenders' recorded security interests under well-established Georgia law. Because of that determination alone, projected through certain key bankruptcy code provisions, Petitioner's attempt to avoid the Respondents' security interests is without merit. There is no need for this Court to undertake yet another review of what has been consistently held by the four courts that have considered these cases below.

JURISDICTION

Respondents do not contest the Petitioner's statement of jurisdiction of this Court.

STATUTORY PROVISIONS INVOLVED

Respondents do not contest the Petitioner's statement of the statutory provisions involved, subject to the following clarifications:

There is no genuine issue for this Court to resolve with respect to the key statutory bankruptcy provisions that are dispositive in these cases.

The first key statutory provision, as stated by Petitioner, is 11 U.S.C. § 547(e)(1)(A). That subsection defines when a transfer of an interest in real property (in this case a security interest of a refinancing lender) is deemed to have been *perfected* by reference to *state law*, and defines that time to be the time at which the purchaser could no longer take an interest superior to the interest being perfected. Petitioner does not contest the application of this statutory provision.

Petitioner's reference to 11 U.S.C. § 547(e)(1)(B) is immaterial to these cases in that it addresses only transfers of interests other than real property. These cases involve transfers of interests in real property only.

The second key statutory provision, as stated by Petitioner, is 11 U.S.C. § 547(e)(2), which defines a transfer of a property interest to have been *made* at the time the transfer takes effect between the transferor and transferee if the transfer is *perfected* within 10 days of the transfer. Although the 10 day grace period for perfection stated above is the period applicable to these cases, a subsequent amendment of this section of the Bankruptcy Code in 2005 has extended the 10 day grace period to 30 days, thus making any issue pertaining to the former 10 day grace period substantially less likely to arise in the years ahead.

The third key statutory provision, which is not stated by the Petitioner in its statement of Statutory Provisions Involved, is 11 U.S.C. § 547(b)(2), which states that one of the required elements for avoiding a transfer of an interest in property is that such transfer have been "for or on account of an *antecedent debt* owed by the debtor before such transfer was made." By applying the three key statutory provisions stated above, together with Georgia law as called for by the first key statutory provision, it is plain that the Petitioner cannot satisfy the prima facie statutory elements necessary to avoid the Respondents' security interests.

Because there is no genuine issue as to application of the key statutory provisions cited above, such that Petitioner cannot satisfy the prima facie elements of a transfer avoidance action, there is no need for this Court to address the question raised by the Petitioner with respect to the substantially contemporaneous exchange defense set forth in 11 U.S.C. § 547(c)(1). Accordingly, contrary to Petitioner's statement of Statutory Provisions Involved, 11 U.S.C. § 547(c)(1) is not a key statutory provision that is necessary to a review of the consistent outcome in the cases below.

RESPONDENTS' STATEMENT OF THE CASE

Two separate adversary proceedings in separate bankruptcy cases were consolidated in the Eleventh Circuit – *Gordon v. NovaStar Mortgage, Inc. (In re Hedrick)* and *Gordon v. ABN Amro Mortgage Group, Inc. (In re Sharma)*. Each case involved a fairly unusual factual setting. Each case involved a situation in which a new lender made a secured real

property loan which served to refinance a prior secured loan. In each case, a security deed securing the prior secured loan had been recorded so as to provide constructive notice of its existence to the world. In each case, the prior security interest was not cancelled of record until *after* the security deed that secured the new refinance loan was recorded. In each case, the refinance lender's security deed was recorded more than 10 days after the date the loan was closed or funded and within ninety (90) days of the filing of a bankruptcy case by the borrower.

In each case, the Petitioner sought to avoid the refinancing lender's security deed because that security deed was recorded within the 90 day reachback period from the date of the borrower's filing of its bankruptcy petition. Citing to the elements for avoidance of a transfer found in 11 U.S.C. § 547(b), Petitioner contended that because the refinancing lender's security deeds were recorded within the ninety (90) day reachback period, and in each case more than ten (10) days after the refinancing loans were closed, they should be deemed to have been made on account of an antecedent debt and thus be avoidable. In each case, the Petitioner freely admitted that the result it sought would be unfair to the refinance lender, while contending that such result was consistent with a supposed purpose of "punishing" a lender who did not assure that its security deed was recorded within the 10 day grace period of 11 U.S.C. § 547(e)(2)(A).

In each case, the bankruptcy court, the district court, and the Eleventh Circuit applied state law, as called for by 11 U.S.C. § 547(e)(1)(A), to establish the

date when the refinance lender's security interest was perfected by determining when a third party purchaser of the property could not have purchased the property so as to hold its interest free and clear of the refinance lender's security interest. In each case, the courts below applied the well-established Georgia law doctrine of equitable subrogation to deem the refinance lender to stand in the shoes of the prior secured lender whose loan had been paid by reason of the refinance lender's secured loan. Each of the courts below recognized that because there was never a time when there was not constructive notice of a recorded security interest of either the prior lender or the refinance lender, then there was never a time when a third party bona fide purchaser for value could have taken an interest in the property that was senior to either security interest.

The courts below thus determined that the refinancing lender's security interest was deemed to have been perfected at the time that it became equitably subrogated to the prior lender's security interest through the payoff of the prior lender's loan, such that the date of payoff became the date of perfection. In both cases, the courts determined that date was at most eight (8) days after the loan was closed.[1] Properly applying Georgia law and applicable Bankruptcy Code provisions to the facts of the NovaStar case, the courts below finally determined

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[1] The bankruptcy court determined that this period was seven (7) days as to the ABN transaction, but the Eleventh Circuit considered this same period to be eight (8) days. All courts below have determined that the respective period in the NovaStar case was eight (8) days.

that, because the date of payoff, and thus the date the transfer of the NovaStar security deed was perfected, occurred outside the ninety (90) day avoidance reachback period, the trustee could not avoid the security deed.

In the ABN case, the date of the payoff, and thus the date of perfection, remained within the ninety (90) day reachback period. However, under the applicable Bankruptcy Code provisions, because such transfer was perfected within 10 days of the date the ABN loan was closed, such transfer was deemed to have been made at the same time the loan was made. Since such transfer was thus not made on account of an antecedent debt, it was not avoidable even though the transfer was made within the ninety (90) day reachback period because 11 U.S.C. §547(b)(2) was not satisfied. Although it was not necessary to do so to resolve the ABN case, the courts below also applied the substantially contemporaneous exchange defense of 11 U.S.C § 547(c)(1) to circumstances giving rise to the time that elapsed between closing and payoff to reach the same result. It is thus unnecessary, albeit correct, to apply the particular facts of these cases to the substantially contemporaneous exchange defense as to which Petitioner takes issue and as to which it notes a conflict among various circuit courts, with the Eleventh Circuit being in the majority of those circuits on this issue.

REASONS FOR DENYING THE PETITION

The following is a summary of the primary reasons why the Petition should be denied:

1. Well-established Georgia law controls the dispositive issue regarding the timing of perfection.

2. The cases involve relatively unusual factual circumstances in which refinancing lenders recorded their security deeds more than 10 days after the refinancing loans were closed, but before the previously recorded security deeds securing the prior, paid off loans were cancelled of record, and the borrower filed for bankruptcy within just a few months of the closing.

3. It is unnecessary to reach the substantially contemporaneous exchange defense issue under bankruptcy law as to which there may be a split in the circuits, because the cases may be decided solely under the above-referenced state law issue as applied to clear federal bankruptcy law.

4. The holdings in the courts below are not inconsistent with any on-point United States Supreme Court decisions.

5. The issues raised in this appeal are not of national importance because they arise from highly unusual circumstances that have become even more unlikely to occur as a result of the change in the credit markets and the amendment of the relevant statute to increase the grace period for perfecting these interests from 10 to 30 days.

These and other reasons for denial of the Petition are set forth more fully below.

I. State law controls the dispositive issue regarding the timing of perfection pursuant to 11 U.S.C. § 547(e)(1)(A).

Certiorari should not be granted because the determination of the date of perfection of the transfer of the security interests at issue in this case is a matter of state law. 11 U.S.C. § 547(e)(1)(A) provides that a transfer of real property is perfected when a "bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee." (Emphasis added.) It is well-established that "applicable law" is state law. *See generally*, 5 Collier on Bankruptcy, 547.05[2] at 547-90 ("The determination of when a transfer is perfected depends entirely on state law." (cites omitted)). In these cases, applicable law is Georgia law, more particularly the Georgia doctrine of equitable subrogation, which controls the date of perfection.

A. Under Georgia law, Respondents, as refinancing secured lenders, were subrogated to the recorded security interests of the lenders whose loans were paid off by their refinancing loans as of the dates of such payoffs.

Well-established Georgia equitable subrogation law provides that "a lender who pays off the lien of a senior creditor may step into the shoes of the senior creditor

as to the priority of the senior creditor's lien." *Greer v. Provident Bank, Inc.*, 282 Ga. App. 566, 567, 639 S.E.2d 377, 379 (2006) (applying equitable subrogation doctrine against bona fide purchaser and in favor of refinance lender).[2] In the cases at hand, Respondents made their loans on the condition that they would obtain a first priority security interest in the subject properties, and their loans served to pay off and refinance the loans of prior senior lenders with previously recorded security deeds. Properly applying Georgia equitable subrogation law, the courts below held that Respondents stepped into the shoes of the prior lenders' recorded security deeds at the time the proceeds of Respondents' refinancing loans paid off those prior senior loans.

B. Under Georgia law, a third party purchaser of either of the properties would have taken such property with constructive notice of and subject to the security interests to which Respondents became subrogated.

Under Georgia law, at no relevant point could a purchaser of either of the properties have taken title without constructive notice of and subject to a senior

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[2] The rule of equitable subrogation originated in an 1898 Georgia Supreme Court case and that court has more recently noted that "[t]he courts incline rather to extend than restrict the principle [of subrogation]." *Davis v. Johnson*, 241 Ga. 436, 439, 246 S.E.2d 297, 300 (1978).

recorded security deed,[3] because the recorded security deeds to which Respondents were subrogated[4] were not cancelled prior to the time the security deeds of the Respondents were recorded. Therefore, the courts below properly held that each Respondent's security interest was perfected[5] under state law for purposes of bankruptcy rules (as directed by Congress in 11 U.S.C. § 547(e)(1)(A)) at the time that it paid off the prior loans and became equitably subrogated to those prior recorded senior security deeds.[6]

In light of the foregoing, these matters, having been resolved through the proper application of Georgia law, are not the proper subject of a writ of certiorari.

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[3] *See, e.g., Matter of Fulton Air Service*, 254 Ga. 649, 650, 333 S.E.2d 581, 582-83 (1985) ("under our recording statutes, if the lien is properly recorded so as to give constructive notice of its existence to all would-be transferees, then the transferee has notice of the lien, and the transferred property in his possession is subject to the lien.")

[4] *See Greer*, 282 Ga. App. at 566, 639 S.E.2d at 377 (purchaser was on constructive notice of prior recorded security deeds to which lender was equitably subrogated and thus could not reasonably expect that its purchase of property would be in senior position.)

[5] As the bankruptcy court noted in the NovaStar case, "a hypothetical bona fide purchaser of property on which there is an outstanding security deed has no legally cognizable expectation that he will acquire the property free and clear of the lien of that deed." (Petitioner's Appendix F at 56) (emphasis added).

[6] Significantly, the *Greer* decision cited the bankruptcy court's Order in the ABN case with approval, demonstrating that the Georgia courts approve of the application of equitable subrogation as used in the ABN (and also NovaStar) case in the courts below. *Id*, 282 Ga. App. at 569, 639 S.E.2d at 380.

C. The federal cases relied on by Petitioner did not involve equitable subrogation and are entirely distinguishable.

Petitioner argues that the application of Georgia's equitable subrogation real property law to determine the date of perfection somehow conflicts with this Court's decisions in *Corn Exchange Nat'l Bank & Trust Co. v. Klauder*, 318 U.S. 434, 35 S. Ct. 679 (1943) (Petition at 15-18) and *Fidelity Financial Services, Inc. v. Fink*, 522 U.S. 211, 118 S. Ct. 651 (1998).[7] (Petition at 10-14.) However, both *Corn Exchange* and *Fink* are readily distinguishable, and it would be an inefficient use of this Court's extremely limited time to grant the Petition to confirm such distinctions.

Petitioner relies on *Corn Exchange*, which was decided under a prior version of the bankruptcy code under different factual circumstances, for the proposition that Congress intended to avoid secret liens held by creditors. However, the *Corn Exchange* decision is inapplicable to the present cases, because at all relevant times the properties here were encumbered by recorded security deeds. Therefore, as discussed above, the interests in question were by no means secret, and a bona fide purchaser would have had constructive notice of such liens.

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[7] Petitioner did not raise *Fink* at all in the cases below. It is not an intervening decision that has been handed down subsequent to any of the proceedings below. Accordingly, Petitioner's arguments based upon *Fink* should not be considered by this Court on review of the cases below. *U.S. v. Galleti*, 541 U.S. 114, 120, 124 S. Ct. 1548, 1552 (2004) (argument forfeited when not raised in courts below).

The *Fink* case is also easily distinguishable. First, it dealt with a transfer of personalty, not a real property transfer such as that involved in these cases. Second, it dealt with the enabling loan (i.e., purchase money loan) exception to the trustee's transfer avoidance power under 11 U.S.C. § 547(c)(3)(B), which is inapplicable to the refinancing loans in the cases below. Third, it dealt with a Missouri law that made relation back of a recordation date to the date of transfer for perfection purposes contingent on recordation within a certain period of time, which is entirely distinguishable from the Georgia doctrine of equitable subrogation pursuant to which a refinancing lender is subrogated to a previously recorded security deed it paid off.[8]

Petitioner also relies upon the readily distinguishable First and Sixth Circuit decisions in *Collins v. Greater Atlantic Mortgage Corp. (In re Lazarus)*, 478 F.3d 12 (1st Cir. 2007) and *Chase Manhattan Mortgage Corp. v. Shapiro (In re Lee)*, 530 F.3d 458 (6th Cir. 2008). (Petition at 19-20.) Neither of those decisions involved application of equitable subrogation where the refinancing secured lender stands in the shoes of the original senior secured lender. Those cases instead involved only the circuit courts' rejection of the applicability of the earmarking doctrine to the facts in question. In the cases below, the bankruptcy and district courts rejected the

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[8] During the period between the transfer date and the recordation date under Missouri law, no recorded lien existed, thus creating a silent lien period. No such silent lien period existed under Georgia's application of equitable subrogation to the refinancing lenders under the facts of the present cases.

applicability of the earmarking doctrine to these cases, and the earmarking issue was not even presented to the Eleventh Circuit. Consequently, the earmarking doctrine, and the cases addressing it, are simply not relevant to this matter.

II. The Court does not need to reach the application of the "substantially contemporaneous exchange" defense contained in 11 U.S.C. § 547(c)(1), because the relevant transfer was not avoidable under 11 U.S.C. § 547(b).

Petitioner argues that a split in the circuit courts exists as to the interpretation of the "substantially contemporaneous exchange" defense of 11 U.S.C. § 547(c)(1), which was employed by the Eleventh Circuit in the ABN matter, in relation to the perfection grace period under 11 U.S.C. § 547(e)(2)(A). However, it is not necessary to reach this defense or any issues pertaining thereto, because the prima facie elements of an avoidable transfer under 11 U.S.C. § 547(b) were not met in the ABN case. This is so because applying Georgia equitable subrogation doctrine and the other applicable bankruptcy provisions to the facts of the ABN matter, the transfer there was not made for or on account of antecedent debt. 11 U.S.C. § 547(b)(2).

As set forth above in Respondent's Statement of the Case, in the ABN matter, applying the doctrine of Georgia equitable subrogation within the context of 11 U.S.C. § 547(e)(1)(A)'s definition of perfection, ABN's security interest was perfected at most 8 days after the loan closing in question. Because each security interest was perfected within 10 days of the closing,

the transfer of such security interest is deemed to have been "made" at the closing pursuant to 11 U.S.C. § 547(e)(2)(A). Since the security interest transfer is deemed to have been made at the same time the debt was created, the transfer was not made for or on account of an antecedent debt. And since the transfer was not made for or on account of an antecedent debt, one essential element of a prima facie case for transfer avoidance under 11 U.S.C. § 547(b) was not met. 11 U.S.C. § 547(b)(2). Without Petitioner having established all of the elements of a prima facie case for transfer avoidance under 11 U.S.C. § 547(b), there is (and was) no need to reach the substantially contemporaneous exchange defense under 11 U.S.C. § 547(c)(1), and any split among the circuits related thereto is not relevant to this appeal.

III. These cases involve relatively rare circumstances and issues that do not raise a question of national importance; future cases similar to these are even less likely to occur due to changes in the credit markets and the extension by Congress of the perfection grace period under 11 U.S.C. § 547(e)(2) from 10 to 30 days.

The consolidated cases on appeal do not raise a question of national importance. Instead, they involve application of well-established Georgia law to an unusual set of factual circumstances.

The issues on appeal are ultimately resolved by reference to Georgia law, as required by the bankruptcy code. They are not issues of national importance on that basis alone.

In addition, in order for the issues in this appeal to come about, all of the following must occur: a loan must be made to refinance an existing loan; the security instrument securing the new loan must not be filed within the federal statutory grace period for perfection; the security instrument securing the new loan must be filed before the security instrument securing the existing loan is satisfied of record; and the borrower must file for bankruptcy within 90 days of recording of the refinancing security instrument.

Even in the recently concluded home mortgage heyday, the bankruptcy of a borrower within just a few months of the making of a loan was no doubt an unusual occurrence. The cases in which that unusual occurrence was coupled with the filing of a security instrument outside the perfection grace period, before the prior security instrument was released, and within 90 days of the bankruptcy, were no doubt even more rare. So even in the absence of any change in circumstances, the issues raised in this appeal did not occur with any great frequency and thus were not of any real national moment.

And there have also been changes in circumstances relating to the scenario that gave rise to this case -- changes that make the issues raised here even less likely to occur in the future. First, the heyday of refinancing is over. Credit standards for home loans are substantially tighter. The notion that lenders will in the future make many loans to borrowers who are so badly off that they will file for bankruptcy in just a few months seems highly unlikely. Without a bankruptcy case soon after the loan is made, the issues raised in this appeal do not arise.

Further, as Petitioner acknowledges, Congress amended the Bankruptcy Code in 2005 to increase the perfection grace period under 11 U.S.C. § 547(e)(2) from 10 days to 30 days. As a result of this extension, it is far less likely that perfection of a refinancing loan security interest will fall outside of that grace period. Prior to the extension of this period, under circumstances similar to those faced by Respondents, a refinancing lender might have had difficulty recording its security deed within the 10 day grace period by reason of circumstances beyond its control, such as slow recordation by government clerks, delays with the mail, holidays, etc. By extending the grace period to 30 days, Congress has rendered it substantially less likely that security interest recordation will take place outside of the grace period. Without a security instrument filing more than 30 days after a refinance loan and without a bankruptcy filing shortly after a refinancing, none of the issues in this appeal will arise in the future. If this happens in the future, it will be infrequently.

In sum, the dispositive issue raised in this appeal ultimately depends upon state law, and the circumstances involved are extremely unlikely to recur frequently in the future, such that there is no important nationwide precedential purpose or substantial likelihood of frequent recurrence that would justify the Court expending its most precious resource – its time - on these consolidated cases.

IV. Conclusion

Petitioner has not established a compelling reason for this Court to grant the Petition. The consolidated cases involve relatively rare factual circumstances governed primarily by Georgia law. Because of the rarity of such circumstances, the recent changes in the credit markets, and the amendment of the Bankruptcy Code in 2005, there is little likelihood that the combination of factual circumstances and bankruptcy issues involved in these two cases will be faced by federal courts with any great frequency in the future. Therefore, Respondents respectfully suggest that the Petition be denied.

Respectfully submitted,

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REPLY BRIEF

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No. 08-370

In The
Supreme Court of the United States

NEIL C. GORDON, as Trustee,
Petitioner,

v.

NOVASTAR MORTGAGE, INC.,
Respondent.

NEIL C. GORDON, as Trustee,
Petitioner,

v.

ABN AMRO MORTGAGE GROUP, INC.,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

PETITIONER'S REPLY BRIEF

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QUESTIONS PRESENTED

1. Is the transfer of an interest "perfected" under 11 U.S.C. § 547(e)(1)(A) only when a secured party has done all the acts required to perfect its interest, or at the moment as of which state law may retroactively deem that perfection effective?

2. In avoiding late-perfected liens under 11 U.S.C. § 547, does the "substantially contemporaneous exchange" defense of § (c)(1) override the stated time limit of § (e)(2)?

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I.

FEDERAL LAW, NOT STATE LAW, CONTROLS THE DISPOSITIVE ISSUE OF PERFECTION UNDER 11 U.S.C. § 547(e)(1)(A).

A. Respondents miss the federal question.

11 U.S.C. § 547(e)(1)(A) provides that "a transfer of real property . . . is perfected when a bona fide purchaser . . . cannot acquire an interest that is superior to the interest of the transferee." Following this Court's analysis in Fidelity Financial Services, Inc. v. Fink, 522 U.S. 211 (1998), Gordon asserts that the transfer is "perfected" under the federal statute ("federal perfection") through a simple, one step analysis: a court must determine when the defendant took the *last* determinative act to perfect its interest under state law ("state perfection"). Here that act was NovaStar filing its own lien, and it occurred on January 7, 2004.

Gordon v. NovaStar ruled that federal perfection took effect at an earlier date, namely, December 12, 2003. That is when another act took place that the Eleventh Circuit determined to be determinative under Georgia law: the lender that NovaStar took out received its payoff. App. C, 20a-21a. That act becomes relevant at all through Georgia law of equitable subrogation. The Eleventh Circuit concerned itself primarily with an explanation of equitable subrogation, and did not expressly apply a last-determinative-act analysis at all.

When we do apply the Fink analysis, we can see where Gordon believes the decision below went wrong,

and why Gordon raises the first question seeking certiorari.

First, the Eleventh Circuit did recognize that NovaStar's last determinative act to achieve state perfection was to file its own lien.[1]

Second, the Eleventh Circuit determined a larger set of facts relevant to state perfection: whether the defendant transferee could be equitably subrogated to the lender it replaced; if so, whether the taken-out lender filed a lien cancellation instrument at any time between closing (December 3, 2003) and the moment of the defendant transferee's lien filing (January 7, 2004); and if so, when the taken-out lender was paid off (December 12, 2003). The Eleventh Circuit then concluded that state perfection became effective as of the moment that the earlier lender was paid off. App. C, 15a-21a. The contingency that in fact occurred on January 7, 2004 – NovaStar filed its lien instrument before the taken-out lender filed its lien cancellation instrument – caused state perfection to be effective 26 days earlier, on December 12, 2003.

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[1] The Eleventh Circuit said this:

> In the present case no bona fide purchaser could acquire an interest superior to NovaStar's because the earlier security deeds were not cancelled until after the NovaStar security deed was recorded . . .. If NovaStar's security deed had not been properly recorded before the other security deeds were cancelled, it would not have been perfected until it was recorded or the world was put on notice by some other means. That, however, is not what happened.

App. C, 20a.

At this point, with no discussion at all, the Eleventh Circuit made a holding of federal law. The Eleventh Circuit held that federal perfection follows state perfection backwards in time. Gordon argues that this holding, albeit sub silentio, conflicts with both Fink and Corn Exchange National Bank & Trust Co. v. Klauder, 318 U.S. 434 (1943).

The Respondents do not address the federal question at all. Instead, the Respondents repeat the Eleventh Circuit's state law points,[2] and they concede that the defendant transferee's own lien filing was the last determinative act:

> [A]t no relevant point could the purchaser of either of the properties have taken title without constructive notice of and subject to a senior recorded security deed, *because the recorded security deeds to which Respondents were*

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[2] The Eleventh Circuit held under Georgia law that the continued recording of the taken-out lender's lien created an absolute presumption of inquiry notice of the new lender's lien. App. C, 18a-19a. Gordon would read Georgia law to create only a rebuttable presumption. Gordon's main brief, p. 6, n. 3. The Reply Brief at p. 9 cites Greer v. Provident Bank, Inc., 282 Ga. App. 566, 639 S.E. 2d 377 (2006). That case assumed only a rebuttable presumption; it which denied a summary judgment motion and sent the case back for trial of disputed facts to determine whether the subsequent purchaser could be charged with inquiry notice of the earlier, unfiled interest. Davis v. Johnson, 241 Ga. 436, 440, 246 S.E. 2d 297, 300 (1978), Reply Brief at p. 9, n. 2, actually restates the common law rule that Congress recognized in 11 U.S.C. § 547(e)(1)(B) (judgment lien creditor test for personalty): although subsequent bona fide purchaser without notice prevails over an equitable subrogee, a subsequent judgment lien creditor, even without notice, does not.

> *subrogated were not cancelled prior to the time the security deeds of the Respondents were recorded.*

Reply Brief at 9-10, footnote omitted (emphasis added).

In short, the Respondents wave state law equitable subrogation as a talisman trumping everything that Congress tried to do in the preference statute. Equitable subrogation is not. Congress created a bona fide purchaser test to encourage prompt public noticing of liens. Although Georgia recognizes equitable subrogation, Georgia gives bona fide purchasers without notice the same priority over equitable subrogees as over any other equities. O.C.G.A. § 23-1-20. Congress created a test in which the last determinative act would be a public noticing, either by lien filing or by possession. Georgia recognizes the same determinative acts for equitable subrogation.

So we are left with the federal question that Fink resolved one way and the Eleventh Circuit resolved the other: if state perfection is deemed as of an earlier date than the occurrence of the last determinative act, does federal perfection follow state perfection backwards in time?

B. Fidelity Financial Services, Inc. v. Fink, 522 U.S. 211 (1998) cannot be distinguished.

The closest guide to a proper interpretation of 11 U.S.C. § 547(e)(1)(A) is Fidelity Financial Services, Inc. v. Fink, 522 U.S. 211, 216 (1998), because Fink interprets the same operative words as they appear in

the companion § (e)(1)(B). The structure of the two provisions is identical: "a transfer of [the kind of property] is perfected when [the hypothetical competing transferee] cannot acquire [the acquired interest] that is superior to the interest of the transferee." Only the competing transferee is different: the BFP for realty transfers; and the judgment lien creditor for personalty transfers.

Fink directs us to the simple methodology stated above. As a matter of state law, the court must find the moment "when the secured party has done all the acts required to perfect its interest[.]" That is the date of federal perfection, whether or not state perfection then goes backward in time. The Respondents fail to distinguish Fink.

The Respondents first note two differences in fact between Fink and this case: Fink involved personalty and a purchase money loan, not, as here, realty and a refinance. Reply Brief at p. 12. However, the Respondents do not tell us why those differences matter. How do those differences in fact cause the identical words, "when . . . cannot acquire," to bear two different meanings in adjacent provisions?

The Respondents then point to differences in the applicable state laws: the "Missouri law . . . made relation back of a recordation date to the date of transfer for perfection purposes contingent on recordation within a certain period of time." Reply Brief at p. 10. By contrast, Georgia made relation back contingent on recordation before the taken-out lender records its lien cancellation instrument, no matter how long it takes.

Again, why does that difference matter? One race is a time trial, and the other is a head-to-head competition, but both are contingencies. The Respondents do not tell us why the words "when . . . cannot acquire" in a federal statute should have one meaning when the defendant transferee races a clock, and other meaning when the transferee races a third party. Either the words "when . . . cannot acquire" relate back along with the state perfection, or they do not. Fink holds that they do not.[3]

II.

HOWEVER REASONED, THE ELEVENTH CIRCUIT'S RULING ON § 547(C)(1) STILL BINDS THAT CIRCUIT AND CONFLICTS WITH TWO OTHER CIRCUITS.

The Respondents argue that the Court need not resolve the circuit split on § 547(c)(1) because the Eleventh Circuit made a gratuitous ruling on that issue. Reply Brief at p. 13. Gordon disagrees. The problem remains that the Eleventh Circuit did rule on this point, and that a circuit split does now exist.

In calling the Eleventh Circuit's ruling on § 547(c)(1) unnecessary, both Gordon and the

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[3] The Reply Brief at p. 11, n. 7 correctly notes that Gordon did not cite Fink below. However, Gordon did make this argument below, citing Corn Exchange National Bank & Trust Co. v. Klauder, 318 U.S. 434 (1943). The second question for en banc consideration was: "2. Assuming that the panel's understanding of Georgia inquiry notice law is correct, is a defendant transferee's interest still not 'perfected' under 11 U.S.C. § 547(e)(1)(A) until the defendant transferee files its deed or possesses the property?"

Respondents note a point of confusion within the writing below. See Gordon's main brief (the "White Brief") at p. 30 and note 14. However, that confusion makes the ruling below no less binding. No trustee may seriously argue within the Eleventh Circuit (other than to the Eleventh Circuit en banc) that § 547(c)(1) does not apply to § 547(e) cases.

The ruling below is law within the Eleventh Circuit, and a circuit split remains.

III.

THE DECISION BELOW CREATES ONGOING PRACTICAL PROBLEMS THAT WILL RECUR IN FUTURE CASES.

The Respondents argue last that "[t]hese cases involve relatively rare circumstances" that are "even less likely to occur due to changes in the credit markets and the extension . . . of the perfection grace period . . .from 10 to 30 days." Reply Brief at p. 14. We disagree. Neither the enlargement of the grace period nor the change in credit markets will soften the effect of the Eleventh Circuit's ruling.

First, the decision below expands the grace period indefinitely. Under the Eleventh Circuit's interpretation of 11 U.S.C. § 547(e)(1)(A), a defendant transferee may delay filing its lien for any length of time at all and escape lien avoidance, as long as the defendant wins the race to filing against the earlier lender's lien cancellation. See the White Brief at p. 14. The change in grace period from 10 days to 30 days pales to insignificance when a lender's perfection may now relate back five years, ten years, or more.

The expansion of the § 547(e) grace period to 30 days may lessen the number of lenders who fail to file within it, but the expansion does not resolve the problem that the § 547(c)(1) "substantially contemporaneous" exception creates. A lender that misses the deadline may still argue that defense. At least one court has held that a filing gap exceeding 30 days still qualified for that defense.[4] In the Eleventh Circuit and elsewhere, trustees, lenders, and courts must still try subjective, case-by-case, factual issues, with no clear rule of decision for determining what the words "substantially contemporaneous" mean in any given context.

In practice, recent changes in credit markets will make the problem that Congress tried to address worse, not better, as follows. States created filing systems in the first place to give prospective purchasers a complete opportunity to learn of prior transfers of interests in property. By definition, as long as a prospective new purchaser cannot find out about an existing lien, then that existing lien remains secret. Congress attempted to discourage secret liens by penalizing those who do not timely give public notice of their liens. See the White Brief at p. 18.

The Respondents assume arguendo "that Congress intended to avoid secret liens[,]" but argue that their liens were not secret "because at all relevant times the properties were encumbered by recorded security deeds. Therefore . . . the interests in question were by no means secret . . .". Reply Brief at p. 11. That leap

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[4] General Acceptance Corp. v. Martella (In re Martella), 22 B.R. 649, 653 (Bankr. D. Co. 1982) (45 day delay).

in logic is wrong. The "recorded security deeds" belonged to others – the taken-out lenders. The fact that an old lender's lien is known through a record filing does not *ipso facto* mean that the new lender's unfiled lien will be found. For starters, nothing in the title records identified the Respondents before the Respondents filed their own deeds.

Every day closing attorneys for prospective purchasers come across old, "open" deeds, i.e., recordings of interests in property for which no cancellations have been filed, but which the seller insists are no longer valid. If liens, they were paid off; if ownership interests, they were relinquished. In the case of a lien, the purchaser's closing attorney will contact the holder of the uncanceled deed, get the payoff amount, and if the subject loan has already been paid off, obtain a cancellation instrument to file.

Of course the closing attorney has a duty to inquire how the loan was paid off. Of course the entity paying it off may assert equitable subrogation or any other rights. But if the seller's take-out lender has not filed its own lien, then the purchaser can learn of that new lender only from the paid-off lender, who is identified on the land records, or the seller, who may lie.

In practice, information on the new lender may not be forthcoming for a number of reasons: the old lender may not have that information; the old lender may for privacy reasons decline to give it out; or the old lender may no longer be found. If the prospective purchaser cannot get that information, so that the new lender's lien remains secret, then we have indeed reached the state of events that Congress sought to discourage through 11 U.S.C. § 547(e), its companion provisions,

and their predecessor statutes since 1903. White Brief at p. 15.

We should then ask, do current events in the credit markets make it more likely or less likely that a purchaser's diligent inquiry will actually discover an unfiled replacement lien? The answer is "less likely." The purchaser's closing attorney could be Sherlock Holmes. Nonetheless, bank failures, consolidations, and job losses in areas of loan administration all decrease the chances that information that is known – the taken-out lender's contact information on its uncanceled lien instrument – will lead to the identity of an entity that is not known, namely, a replacement lender such as the Respondents here.

As before, the new lender can with little effort make all that extra work unnecessary and return complete certainty to the marketplace. All the lender has to do is to file its lien. Now is the time to reconfirm Congress's intended prod to encourage prompt filings. The Eleventh Circuit's ruling blunts and softens Congress's efforts. The Eleventh Circuit's timing could not be worse.

Bankruptcy trustees and other parties need rulings on both of Gordon's questions. Gordon requests that the Petition be granted.

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